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INVESTMENT TRUSTS AND INVESTMENT COMPANIES

LETTER

FROM THE

CHAIRMAN OF THE
SECURITIES AND EXCHANGE COMMISSION

TRANSMITTING, PURSUANT TO LAW, A REPORT ON
COMPANIES SPONSORING INSTALLMENT
INVESTMENT PLANS



September 28, 1939.—Referred to the Committee on Interstate and Foreign Commerce and ordered to be printed with illustrations

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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., September 22, 1939.

SIR: I have the honor to transmit herewith a report on companies sponsoring installment investment plans, which supplements the Commission's over-all report on its study of investment trusts and investment companies made pursuant to Section 30 of the Public Utility Holding Company Act of 1935. This report is one of a series of supplemental reports to be transmitted to the Congress by the Commission on special phases of its study of investment trusts and investment companies. The Commission's final conclusions and recommendations with respect to companies sponsoring installment investment plans will be included in that part of its over-all report which will contain the Commission's conclusions and recommendations on investment trusts and investment companies.

Part One, Part Two, Chapters I and II of Part Three of its over-all report, and three supplemental reports have heretofore been transmitted by the Commission to the Congress. Part One, transmitted on June 10, 1938, consists of a discussion of the nature, classification, and origins of investment trusts and investment companies, and has been printed as House Document No. 707, 75th Congress. Part Two, the transmission of which was completed on March 10, 1939, consists of a statistical survey of investment trusts and investment companies, and has been ordered printed as House Document No. 70, 76th Congress. Part Three, of which the most recent section was transmitted on August 7, 1939, deals with the abuses and deficiencies in the organization and operation of investment trusts and investment companies, and has been ordered printed as House Document No. 279, 76th Congress. The supplemental report on investment trusts in Great Britain was transmitted on June 26, 1939, and has been ordered printed as House Document No. 380, 76th Congress, while the two supplemental reports, one on investment counsel, investment management, investment supervisory, and investment advisory services, and the other on commingled or common trust funds administered by banks and trust companies were transmitted on August 17, 1939, and August 30, 1939, respectively.

The study was under the general supervision of Commissioner Robert E. Healy, with Paul P. Gourrich, former technical adviser to the Commission as director of the study, the late William R. Spratt, Jr., as chief of the study, David Schenker as counsel, and L. M. C. Smith as associate counsel. Paul P. Gourrich, former director of the study, whose resignation from the Commission was submitted on March 31, 1939, did not participate in the preparation or consideration of this report.

This supplemental report on companies sponsoring installment investment plans was under the immediate supervision of Lawrence M. Greene of the legal section of the staff. I. S. Weissbrodt of the legal section of the staff collaborated on particular aspects of the report.

By direction of the Commission:

JEROME N. FRANK, *Chairman,*

THE PRESIDENT OF THE SENATE,

THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,

Washington, D. C.

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Chapter I

NATURE OF STUDY AND SOURCES OF MATERIAL

A. AUTHORITY FOR STUDY

This report on companies sponsoring installment investment plans is supplemental to the over-all report of the Securities and Exchange Commission on its study of investment trusts and investment companies which the Commission was directed to make by Section 30 of the Public Utility Holding Company Act of 1935.¹

The so-called "installment investment plan" type of investment trust and investment company is accorded separate treatment by the Commission in its study of investment trusts, because of the distinctive features that this type possesses.

B. SOURCES OF MATERIAL

On March 21, 1936, a detailed questionnaire was sent to each company known to be engaged in the business of sponsoring or distributing installment investment plans, covering their operations from their inception to December 31, 1935.² Subsequently, supplementary information was requested from the sponsor companies covering certain phases of their activities and operation of the plans during 1936 and 1937. No field examination of any of these companies was made. However, preliminary conferences and public hearings were held with respect to the operation of four of the larger sponsor companies.³ The material and data obtained from the questionnaire replies, public examinations, and securities registration statements filed under the Securities Act of 1933, constitute, in large part, the factual basis for this report. None of the facts elicited in this manner was independently checked by the Commission's staff through field studies.

Numerous complaints of fraud and misrepresentation and of other violations of the Securities Act of 1933 in connection with the sale of certificates of these plans have been made by certificate holders. As a result the Commission instituted investigations, some of which are still pending, of the sales practices of various sponsor companies.⁴

¹ See Pt. One (House Doc. No. 707, 75th Cong.) of the Commission's Report, Ch. I, for discussion of the authority and scope of the study.

² Replies to the questionnaire were received for 37 installment investment plans. These plans, together with the plans for which registration statements were filed under the Securities Act of 1933, in the period up to December 31, 1937, are listed in Pt. One (House Doc. No. 707, 75th Cong.) Appendix A, pp. 114-149. See also Appendix A of this report.

³ These companies are: Financial Independence Founders, Inc., Independence Fund of North America, Inc., Income Foundation, Inc., and Transcontinent Shares Corporation.

⁴ These investigations resulted in the institution of injunction proceedings against eight of the larger sponsor companies. Consent decrees enjoining the sponsor companies from continuing to engage in these practices were obtained against six of these companies. One proceeding was stayed upon stipulation by the sponsor company that it would not engage

Material in connection with these proceedings was also used in this report.

This report, after reviewing the nature, origin, and growth of installment investment plans, will then discuss the general structural characteristics of installment investment plans, and finally the problems and defects in connection with the creation, operation, and distribution of these plans.

in the practices alleged to have occurred. One action is still pending in a federal district court.

A more complete discussion of these injunction proceedings appears in Ch. V, Problems and Defects in Connection with Distribution, *infra*.

Chapter II

NATURE, ORIGIN, AND GROWTH OF INSTALLMENT INVESTMENT PLANS

A. GENERAL CHARACTERISTICS OF INSTALLMENT INVESTMENT PLANS

Early in 1930 a somewhat novel variety of investment scheme, called variously "installment investment plan," "periodic payment plan," "thrift plan," "foundation plan," et cetera, was conceived. The originators claimed that these plans were created and developed in order to fill an economic need; namely, to furnish to people of small but steady income a program for investment in common stocks through the purchase of an investment trust or investment company certificate or security on the installment plan. The scheme was specifically designed to make its strongest appeal to wage-earning men and women who could afford to set aside periodically only small amounts of money from their earnings or funds. Thus, the salient feature of these plans was the arrangement providing for relatively small payments by a subscriber on an installment basis. Payments as low as \$10 or even \$5 a month were possible under this new investment device.¹ This small installment payment feature, it was thought, would have a "tremendous selling appeal" and would attract a class of people who had never before purchased equity securities.

The structure and method of operation of this periodic payment or installment investment plan, the rights and liabilities of the parties, and, in general, all the features of this new investment medium were influenced by the fact that this investment vehicle was designed specifically to attract the savings of a new and wider section of the public—individuals in the lower income brackets. In order to increase the sales allurements of the plan and to strengthen the claim of "protection" held out by promoters, an optional provision for life insurance was generally offered,² and to attract the funds of those who could afford to make a fairly substantial lump sum investment, a "fully-paid certificate" was also sold.³

Stripped of its embellishments, however, the installment or periodic investment scheme was a contrivance for selling the familiar varieties of investment trust or investment company securities on a periodic or installment payment basis. Certificates representing participation

¹ The basic unit of most plans was \$1,200, payments being made at the rate of \$10 a month for 120 months.

² Public Examination, Financial Independence Founders, Inc., at 6441.

³ *Id.*, at 6329. Although the fully-paid plan is a distinct type of investment medium comparable to the outright purchase of investment trust shares or investment company stock, for practical reasons it has been included in the statistics in this report covering the sale and performance of installment plans. The number of fully-paid plans sold by sponsor companies was estimated to be not over 10% of the total of all plans sold. (See Table 1, *infra*.)

in the installment investment plan were the "securities" which were sold directly to the public. The certificate or "security" sold to the public evidenced the beneficial ownership of the holder of the certificate in an account to which were credited shares or interests in other securities "underlying" the installment investment plan. Under most of the plans these underlying securities were shares of another designated investment trust or investment company—either a fixed investment trust or an open-end management investment company. Investment was specifically limited to the shares of the investment trust or investment company selected. In other cases the underlying securities purchased under the plan were common stocks in which beneficial participations were credited to the certificate holder. In other words, substantially, a certificate or security was sold to the public on the installment plan which represented an interest in some underlying security—a security of a fixed trust or of a management investment company (either closed-end or open-end) or a diversified group of portfolio securities.⁴

The payments were usually made periodically to a so-called "trustee" who used the funds received to purchase the particular underlying securities specified in the plan, after deduction of fees and charges.⁵ The plan provided that periodic payments be made over a definite period of time, generally \$10 monthly payments for ten years. With each successive payment, additional underlying shares or participation in shares were purchased and credited to the individual account of the certificate holder. In reality, a participant in the installment plan was an investor in the underlying shares of an investment trust or investment company. The method by which the investor purchased these investment trust or investment company shares was virtually the only change effected by the new installment payment device. However, a distinct and separate investment mechanism was involved. In essence, "a trust on a trust" arrangement was created with two sets of charges and deductions imposed for each of these trusts.

In this report, the companies which are engaged in the business of organizing these investment devices and in selling certificates which constitute participations therein are called "sponsors." The investment devices themselves are called "installment investment plans." The purchasers of participations in the plans are called "subscribers" or "certificate holders." The investment trust or investment company shares or portfolio stocks which directly underlie the installment investment plan or installment investment certificate are designated the "underlying securities." In those plans utilizing the "trust on a trust" arrangement, the securities invested in by the underlying investment trust or investment company are termed "portfolio stocks."

B. ORIGIN OF INSTALLMENT INVESTMENT PLANS

Installment investment plans had their counterparts in the various methods and vehicles for periodic saving or buying which have long been familiar in this country. The installment buying of ordinary

⁴ For detailed description of these various types of investment trusts and investment companies see Pt. One of the over-all report (House Doc. No. 707, 75th Cong., Ch. II, p. 21, et seq.).

⁵ In a number of instances, payments were required to be made to the sponsor company, which then turned over the funds received by it to the trustee.

merchandise has been wide-spread and popular during the last two decades.⁶ Methods of payment for securities in installments have been commonly used by industrial organizations in connection with employee stock ownership plans since 1900.⁷ The public was well acquainted with savings bank thrift plans, insurance company endowment plans, guaranteed face amount installment certificate plans, and building and loan plans, all of which made use of some method of periodic payments.

The installment investment plan, however, was essentially different from those programs created by savings banks, building and loan associations, insurance companies, and face amount installment certificate companies.

The principal characteristic which distinguished the installment investment plan from the other plans mentioned was that the holder of an installment investment plan certificate occupied the status or position of a purchaser of an investment trust or investment company security and not of a creditor of a banking or monied institution.⁸ The certificate holder in the installment plan essentially was a participant in an underlying fund or portfolio of securities, mainly common stocks, which constituted the portfolio of the investment trust or investment company which underlay the installment plan certificates.⁹ His participations or shares were held by one so-called trustee, and the portfolio stocks themselves were held by the same, or, in most instances, another trustee. Thus, the certificate holder was the beneficiary of an investment trust which held shares of another investment trust, which in turn held a portfolio of securities. In essence, a purchaser of an installment investment plan certificate buys common stocks or an interest in a common stock fund on the installment plan. Because of the confusion which may be engendered by the complex structural organization of these installment investment plans it should be emphasized that the purchaser of an installment investment certificate is investing or speculating in common stocks. As a consequence, the certificate holder is not entitled to a fixed specified amount but is entitled in substance only to the market value of the common stocks in which he has indirectly acquired an interest. This market value, of course, fluctuates and, consequently, the amount to which the certificate holder is entitled fluctuates accordingly. His principal appreciates or depreciates in accordance with the appreciation or depreciation of the underlying securities and his income depends

⁶ It is important to note that the installment investment plan is fundamentally different from ordinary installment buying. The installment buyer of a commodity (whether merchandise or securities) usually receives the immediate possession or use or profits of the entire commodity purchased although payment for it is spread over a period of time. This is not true of the installment investment plan in which the purchaser receives no more securities than his payments, less fees and charges, can buy. Other distinctions also exist. This report does not purport to deal with the merits or demerits of ordinary installment buying.

⁷ Forester, Robert, and Dietel, Else, *Employee Stock Ownership in the United States* (1926). Princeton University.

⁸ Manifestly, other distinctions may exist. The method of distribution, the type of investment medium underlying the programs, the presence or lack of management or supervision, and the method of compensation to the promoters and distributors, are some of the differences that might be indicated between the installment plan and one or more of the programs mentioned.

⁹ This report deals only with those installment or periodic payment plans which have equity securities (that is, common stocks) as the principal basic investment.

on the dividends earned by these securities. The value of the installment certificate, therefore, may be less than, equal to, or more than the amount paid by the certificate holder, depending upon stock market conditions and the market value of the underlying common stocks. In those plans promulgated by savings banks, insurance companies, building and loan associations, and face amount installment certificate companies, the investor is entitled to be repaid a definite sum of money or a fixed amount of income as agreed, and this amount, of course, is not dependent upon the market value of any underlying property.¹⁰

As has been indicated, the originators of the concept of the installment investment device urged these plans as an economic necessity for the individuals in the lower income brackets. However, it was virtually the unanimous opinion of all sponsors as expressed to the Commission that no individual should purchase these plans unless he had a sufficient amount of his income and capital in savings banks and insurance and that the plans were only intended as a medium of investment for any excess.

John L. Thomas, president of Financial Independence Founders, Inc., one of the first companies in the field, testified concerning the origin of the installment investment plan as follows:¹¹

Q. I would like to get the background, a little bit about the industry, how it started, and whose ideas these plans were in the first place, and what type of investor you are trying to serve by this industry. And then I would like to get a few figures on the size and growth of the industry.

A. The idea behind this business, I think came from two sources. One of them was the Raskob plan, which was very successfully used in General Motors, and the plan which was written up in the Saturday Evening Post by Frank A. Vanderlip. That appeared in a series of articles in the Post. I think that the ideas set forth by these two men——

Q. Which Raskob is that?

A. John J. Raskob.

Those two men had had experience in the handling—in the case of Raskob employees' monthly deposits, and in the case of Mr. Vanderlip the public's monthly deposits, and the investment of those deposits in a well diversified group of common stocks.

In the case of Raskob, there wasn't so much diversification, but it was a common stock investment.

And both of these men expressed the idea, and the thought behind the plan was that, by a set-up of this kind it would be possible to get persons with a small amount of money into the money-making end of industry as distinguished

¹⁰As will be discussed more fully infra, in Ch. V. Problems and Defects in Connection with Distribution, the distributor of installment investment plan certificates often encouraged the "unsophisticated" investor (to whom the plan was intended particularly to appeal) to assume that the installment investment plan was of the same general nature as savings bank plans, thrift plans, endowment plans, and building and loan plans, and that the certificate holder would get his money back at any time—i. e., the amount he had paid on the certificate. The construction and nomenclature of the installment plan were so designed that they lent credence to this impression. The plausibility of such identification in the mind of the public was strengthened by the use, in its publicity, of terms customarily associated with banking or insurance institutions. Indeed the impression, in some instances, was given in more pointed and direct fashion, that these plans were similar to savings bank thrift plans or insurance endowment plans.

¹¹Op cit. supra, note 2, at 6228.

from savings entirely; that persons who actually acquired interests in sound companies would have an opportunity to make some money as distinguished from pure saving it at a fixed rate of interest. That is the background of the thing.

Henry J. Simonson, president of Independence Fund of North America, Inc., another early company in the field, testified as follows:¹²

A. This type of business, so far as we are concerned, was originated by ourselves, to fill what we felt was an economic need, namely, to create an opportunity for a person of small means to have an investment program designed for accumulation over a period of years.

Q. Was the industry started by you?

A. We were the first company in the field, and I believe I was the originator of the idea.

Q. Had the idea been suggested to you by any of these other articles on the subject?

A. The idea was suggested to me primarily because of the fact that it was apparent, due to a previous affiliation, that persons with an income could make periodic payments, either to liquidate an indebtedness, or if they did not have such an indebtedness, to an investment program.

Q. Did you read the Raskob articles and the Vanderlip articles?

A. Yes. The Raskob article, which is an interview with Mr. Raskob, appeared in the *Woman's Home Companion* about the time we were in the process of our research work, preliminary to the organization of this company. I wouldn't say that the Raskob experience was the basis of our starting this company, because we had begun our research work prior to the time the Raskob article appeared, and prior to the time I knew anything about such a program.

David W. Barton, president of Income Foundation, Inc., which was organized in 1931, and was the sponsor of a widely sold installment plan, testified to the same effect but admitted that the profit derived from sales was a factor that influenced his promotion of the plan:¹³

Q. For what reasons did you desire to go into the distribution of investment-plan contracts?

A. I had for some time been interested in various forms of semicompulsory saving. I had also felt that opportunity should be made whereby the small investor would be able to buy high-grade securities, which prior to that time, as I saw it, was only available to men of considerable means. In addition to that, I felt that if a systematic plan of purchase could be mapped out, and the temptations to take advantage of market fluctuations could be avoided, such a plan would fill an economic need and would serve a purpose. That I think was primarily my main incentive at the time.

Q. What profit motive did you see for yourself in the distribution?

A. All my training has been in selling. It seemed to me that such a plan would have a tremendous appeal and could be sold readily.

While "economic need" was generally asserted to be the justification for the creation of this type of investment medium, apparently no analytical study had been made to determine this necessity.

¹² Public Examination, Independence Fund of North America, Inc., at 6455.

¹³ Public Examination, Income Foundation, Inc., at 11558.

Alfred H. Geary, president of Capital Savings Plan, Inc., admitted that his belief in the installment plan as an "economic need" was merely based upon his "background and experience":¹⁴

Q. Did you feel that there was an economic need for this medium of investment? In the thrift plan of investment trust?

A. Yes.

Q. What do you base that upon?

A. It gives the person of moderate means an opportunity of acquiring investments in stocks.

Q. Why can't he do that by accumulation of investment shares?

A. He just doesn't think of investments in terms of \$20.

Q. Did you believe it was worth while to educate him into thinking of purchasing stock in terms of \$20?

A. Yes; I did.

Q. Even though it means paying a high commission?

A. Yes.

Q. Did you make any study of that before you decided to go into this business or is that something you came to think of later?

A. No.

Q. Any detailed studies?

A. No study at all. No detailed actuarial work.

Q. So that any belief that there was an economic need for that medium of investment would have been based upon your background and experience, generally, not upon any detailed study?

A. Correct.¹⁵

Another point of view as to the origin is that the installment investment scheme was devised merely as an additional method of selling fixed or semifixed trust shares. Louis Wence, secretary of Transcontinent Shares Corporation, the successor of Bank and Insurance Shares, Inc., sponsor of two early installment plans, testified:¹⁶

Q. What was the purpose of forming these plans?

A. It was to give the small investor an opportunity to invest his money in the New York bank stocks and the leading insurance stocks of the United States.

Q. All it really was is a scheme where the small investor, who did not have a sufficient amount of funds to purchase the unit trust shares, could purchase those same shares on the installment plan. It was purely a sales scheme, wasn't it?

A. I wouldn't say that. It gave the man an opportunity to invest \$10 a month. If you took \$10 and endeavored to buy the trust shares, you could only purchase two shares—based on the price—whereas in the savings plan you could invest the entire \$10, and as we go on it will be explained in more detail why it is better to go into the plan.

Q. But from your point of view, it made possible the sale of trust shares to people who could not or otherwise would not purchase trust shares?

A. That is true.

¹⁴ *Hearings in the Matter of Capital Savings Plan, Inc.*, held on May 24, 1938, pursuant to order for investigation dated February 21, 1938, under Section 19 (b) and Section 20 (a) of the Securities Act of 1933, pp. 68-9.

¹⁵ The ensuing sections of this report will indicate the extent to which the desires of the promoters to create a medium of investment with an economic justification failed of realization.

¹⁶ Public Examination, Transcontinent Shares Corporation, at 13895.

In any event, the possibility of profits from the sale of installment plan certificates naturally attracted promoters to the field. Mr. Barton conceded this.¹⁷ When examined on this point, Mr. Geary, president of Capital Savings Plan, Inc., testified:¹⁸

Q. Certainly you entered this business because of your own needs—to make money?

A. That is right.

Q. Because you were in a business that was not going so well, according to your testimony?

A. That is right.

Q. You saw an opportunity to make money for yourself?

A. That is right.

Q. And you saw tremendous sales possibilities in these plans?

A. Yes.

Q. When you looked into this plan you thought there might be an unlimited selling field if you could get this thing organized and started?

A. Yes.

Q. And you saw other companies in this business—four other companies had entered this business?

A. Yes.

C. GROWTH OF INSTALLMENT INVESTMENT PLANS

As has been indicated, installment investment plans made their first general appearance in 1930.¹⁹ In that year five plans were offered to the public, sponsored by four companies, Independence Fund of North America, Inc., Financial Independence Founders, Inc., Euclid Investors, Inc., and Thrift Investment Association. Each year thereafter the number of sponsor companies and the number of plans increased.

The chronological growth of the installment investment plan in this country was as follows:

Year	Number of new sponsor companies	Number of new plans	Number of plans in ex- istence at year-ends
1929.....	1	1	1
1930.....	4	5	5
1931.....	10	12	17
1932.....	11	15	32
1933.....	4	5	35
1934.....	1	2	33
1935.....	6	11	41
1936.....	2	4	45
	39	55	-----

¹⁷ Op. cit. supra, note 13, at 11558.

¹⁸ Op. cit. supra, note 14, at 65.

¹⁹ Union Investment Trust Certificates (Series A), sponsored by Union Deposit Company, were first issued in December 1929 (Securities Registration Statement, Union Deposit Company, Post-Effective Amendment filed with the Securities Division of the Federal Trade Commission, July 17, 1933, p. 1).

Likewise, the number of certificates sold to the public and the amount of assets held in connection with installment investment plans steadily increased. The volume of sales of certificates by quarter periods from January 1, 1930, to December 31, 1936, of 32 installment investment plans sponsored by 27 companies, for which quarterly figures are available, is shown in Table 1.²⁰ In summary, annual distribution was as follows:

Annual distribution of Investment Plan Certificates

Year	Maximum number of plans	Number of certificates sold	Total amount payable
1930.....	3	3, 323	\$5, 388, 460
1931.....	8	14, 192	19, 954, 850
1932.....	16	10, 292	15, 047, 402
1933.....	24	11, 294	16, 598, 805
1934.....	23	13, 655	20, 493, 147
1935.....	26	18, 000	26, 389, 414
1936.....	25	29, 459	48, 770, 940
Total.....		100, 215	152, 643, 018

NOTE.—Chart 1 portrays the amount of sales of installment investment plan certificates cumulatively and for quarterly periods.

TABLE 1.—Sales of Investment Plan Certificates by sponsors and their dealers, 1930–36

NUMBER OF CERTIFICATES SOLD

Year	Quarter	Num-ber of plans	By sponsor's own organization		By independent security dealers		Total of all sales
			Fully-paid	Periodic payment	Fully-paid	Periodic payment	
1930.....	First.....	0					
	Second.....	1	2	172			174
	Third.....	2	10	1, 357			1, 443
	Fourth.....	3	15	1, 501			1, 706
1931.....	First.....	3	20	1, 939	17	1, 183	3, 159
	Second.....	5	52	2, 472	43	1, 463	4, 030
	Third.....	8	43	2, 238	26	1, 086	3, 393
	Fourth.....	7	49	2, 721	23	817	3, 610
1932.....	First.....	9	50	2, 571	18	355	2, 994
	Second.....	11	41	1, 849	20	223	2, 133
	Third.....	12	70	2, 233	12	272	2, 587
	Fourth.....	16	68	2, 340½	6	163½	2, 578
1933.....	First.....	17	69	2, 016½	7	171½	2, 264
	Second.....	20	118	2, 113	19	503	2, 753
	Third.....	20	147	2, 118½	21¼	451	2, 737¼
	Fourth.....	24	140	2, 862	31	507	3, 540

²⁰ This table, showing the number of certificates sold (of the fully-paid as well as the periodic payment type), the type of sales organization through which sales were made, and the total amount payable for all sales, is based upon replies to the Commission's questionnaire. It does not include those plans for which replies to the questionnaire could not be obtained by the Commission. It is believed that the omitted plans would, to some extent, affect the figures for the volume of sales for 1935 and 1936.

TABLE 1.—*Sales of Investment Plan Certificates by sponsors and their dealers, 1930-36—Continued*

Year	Quarter	Num- ber of plans	By sponsor's own organization		By independent security dealers		Total of all sales
			Fully-paid	Periodic payment	Fully-paid	Periodic payment	
1934.....	First.....	23	159	2,526½	19	297	3,001½
	Second.....	21	183	2,941	51	508	3,683
	Third.....	21	132	2,446½	16	349	2,943½
	Fourth.....	20	250	3,332	24	421	4,027
1935.....	First.....	22	234	3,669	20	401	4,324
	Second.....	24	283	3,703½	39	374	4,399½
	Third.....	23	333	3,275½	36	350	3,994½
	Fourth.....	26	476	4,297	42	467	5,282
1936.....	First.....	25	654	6,022	18	225	6,919
	Second.....	23	621	5,388	22	333	6,364
	Third.....	23	716	6,193	21	304	7,234
	Fourth.....	23	1,126	7,416	40	360	8,942
Total.....	.....	.....	6,061	81,713½	591¼	11,840	100,215¼

TOTAL AMOUNT PAYABLE OF CERTIFICATES SOLD

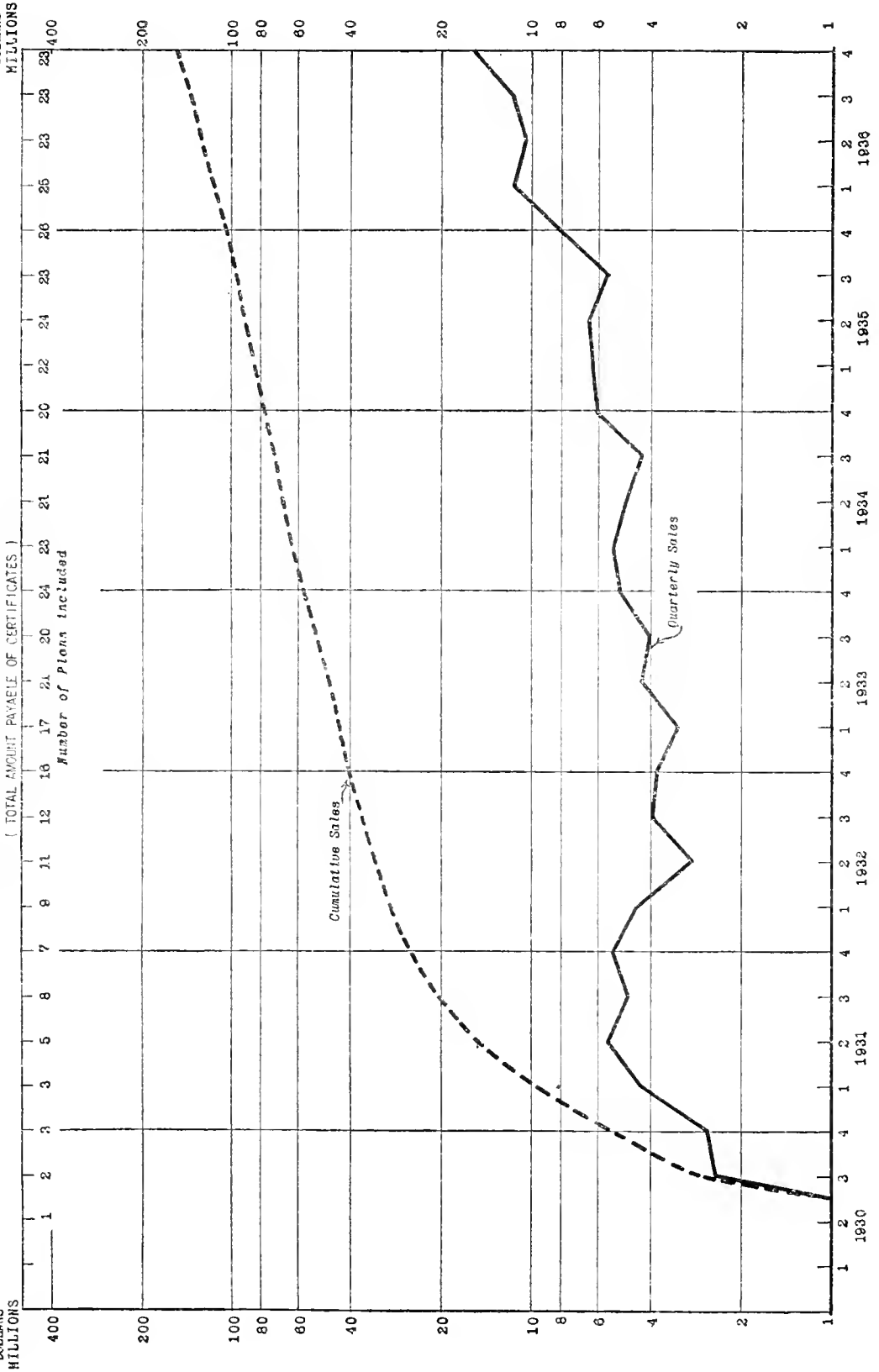
1930.....	First.....	0	.....	.....	.....	.....	.....
	Second.....	1	\$3,000	\$364,800	.....	.....	\$367,800
	Third.....	2	10,000	2,336,400	.....	\$91,200	2,437,600
	Fourth.....	3	19,500	2,335,560	.....	228,000	2,583,060
1931.....	First.....	3	13,000	2,833,200	\$8,500	1,419,600	4,274,300
	Second.....	5	33,000	3,770,410	21,500	1,755,600	5,580,510
	Third.....	8	29,760	3,430,960	13,000	1,306,380	4,780,100
	Fourth.....	7	43,720	4,248,080	11,500	1,016,640	5,319,940
1932.....	First.....	9	46,180	3,940,230	9,000	446,070	4,441,480
	Second.....	11	48,900	2,581,190	10,760	266,940	2,907,790
	Third.....	12	235,182	3,281,840	167,100	236,500	3,920,622
	Fourth.....	16	136,000	3,424,160	59,100	158,250	3,777,510
1933.....	First.....	17	102,251	2,909,950	51,800	145,505	3,209,506
	Second.....	20	238,114	3,040,540	73,600	923,750	4,276,004
	Third.....	20	152,040	3,078,675	40,500	783,935	4,055,150
	Fourth.....	24	117,700	4,114,575	40,900	784,970	5,058,145
1934.....	First.....	23	167,420	4,645,495	52,750	448,245	5,313,910
	Second.....	21	129,485	3,976,230	50,300	678,350	4,834,365
	Third.....	21	152,480	3,553,040	42,500	526,095	4,294,115
	Fourth.....	20	305,432	5,029,570	51,700	664,055	6,050,757
1935.....	First.....	22	253,965	5,304,050	53,400	609,493	6,220,908
	Second.....	24	301,729	5,457,570	62,011	572,851	6,394,161
	Third.....	23	388,847	4,785,010	30,900	558,670	5,763,427
	Fourth.....	26	663,113	6,562,180	44,200	741,425	8,010,918
1936.....	First.....	25	731,585	10,225,125	17,100	442,500	11,416,310
	Second.....	23	745,041	8,975,470	23,250	599,400	10,343,161
	Third.....	23	919,359	9,831,460	16,100	639,000	11,405,919
	Fourth.....	23	1,393,059	13,367,535	69,956	775,000	15,605,550
Total.....	.....	.....	7,379,862	127,403,305	1,021,427	16,818,424	152,643,018

Each year's sales of investment plan certificates were consistently greater than the previous year's, except the sales for 1932. The largest dollar gain in the amount sold occurred in 1936 when the industry roughly increased 50% in total amount payable of certificates sold.²¹

²¹ It is believed that data for certificates sold in 1937, if available, would show a continued increase.

CHART I

SALES OF INSTALLMENT INVESTMENT PLAN CERTIFICATES



The constant increase in sales may be attributed in part at least to the development of the sales staffs of the sponsor companies which sold certificates directly to the public. Although independent dealer organizations at first accounted for a large part of the sale of installment plan certificates, their importance in selling this type of security gradually dwindled. Reliance was placed more and more upon the sponsors' own sales organizations which began to conduct sales campaigns in much the same way as the sales organizations of large business enterprises.²²

The following figures, which illustrate even more graphically the progressive growth of the installment plan industry, show the annual amount of payments received from investors in connection with 43 different installment plans up to and including 1937. While the figures do not cover every plan, they cover practically the bulk of the industry.²³

Year	Number of plans	Payments by certificate holders	Year	Number of plans	Payments by certificate holders
1930.....	2	\$157, 690	1935.....	35	\$7, 633, 079
1931.....	9	1, 073, 949	1936.....	35	14, 871, 644
1932.....	20	2, 451, 723	1937.....	31	19, 660, 193
1933.....	24	3, 679, 302			
1934.....	24	5, 209, 956	Total.....		54, 737, 566

The total assets as at each year-end for the period 1930-1937, based on market value, of installment investment plans also showed progressive growth despite withdrawals by certificate holders and depreciation in market value of the underlying securities.²⁴

Installment plan certificates were widely sold. The geographical distribution of certificate holders is shown in Table 2. These figures indicate the widespread diffusion of the installment plan. As at December 31, 1935, residents of 45 states, District of Columbia, Panama, and three territories were subscribers to installment plans.

Measured solely by amount of total funds of the public invested or by aggregate assets, these plans do not loom large in the total picture of all investment trusts and investment companies examined in this Study. At the end of 1936 the aggregate assets of all investment plans constituted approximately $\frac{1}{2}$ of 1% of the aggregate total assets of all investment trusts and investment companies. Although the installment investment plan is only a small part of the entire investment company business, it is significant from the standpoint of the type of investor to which these plans are sold—individuals in the low-income brackets and the salaried and wage-earning class.

Furthermore, the relative importance of these plans is not truly indicated by a comparison of their total assets with the grand total of assets of all investment trusts and investment companies. Since the certificates representing participation in these plans are purchased on a periodic payment basis, and since most of the plans have been

²² See Ch. V, *infra*, Problems and Defects in Connection with Distribution.

²³ These figures are based upon information disclosed by securities registration statements for several installment plans as well as the replies to the Commission's questionnaire.

²⁴ See Appendix G.

in existence for a short time, only a small percentage of the agreed payments have been made by certificate holders. In the normal course of events, even assuming no further sales of certificates, the total funds of these plans will steadily grow larger unless withdrawals occur. Moreover, the number of certificate holders in the installment plan field was relatively much greater than the proportion of assets of the plans to the total assets of investment trusts and investment companies.²⁵ By the end of 1936, 100,000 installment-plan certificates had been sold to the public. A large number of additional certificates have been sold since then.²⁶ The per capita investment of certificate holders was much less than that of stockholders in other types of investment mediums, which accounts for the relatively small amount of assets held in this field.²⁷

TABLE 2.—*Geographical distribution of certificates of 30 installment investment plans in force as at Dec. 31, 1935*

Geographical area	Certificates in force		Geographical area	Certificates in force	
	Number	Amount payable (dollars)		Number	Amount payable (dollars)
Alabama.....	23	37,800.00	New Jersey.....	1,747½	2,949,438.00
Arizona.....			New Mexico.....	298	385,500.00
Arkansas.....	264	373,470.00	New York.....	6,686	15,964,483.03
California.....	542	931,230.00	North Carolina.....	27	34,200.00
Colorado.....	1,018	1,242,400.38	North Dakota.....	27	34,300.00
Connecticut.....	319	552,065.25	Ohio.....	38	495,675.00
Delaware.....	(a)	59,435.00	Oklahoma.....	52	259,325.00
District of Columbia.....	312	1,618,660.00	Oregon.....	2	3,600.00
Florida.....	87½	1,481,000.00	Pennsylvania.....	11,027½	18,367,385.00
Georgia.....	95	254,860.00	Rhode Island.....	57	342,225.00
Idaho.....	1	6,000.00	South Carolina.....	8	102,600.00
Illinois.....	550	1,800,040.57	South Dakota.....	160	225,700.00
Indiana.....	44	238,900.00	Tennessee.....	20	157,580.00
Iowa.....	23	54,400.00	Texas.....	136	357,200.00
Kansas.....	188	373,060.00	Utah.....		
Kentucky.....	58	90,060.00	Vermont.....	1	1,260.00
Louisiana.....	22	96,490.00	Virginia.....	116½	242,650.00
Maine.....	26	34,545.00	Washington.....	3	158,500.00
Maryland.....	911	1,744,960.00	West Virginia.....	102	533,720.00
Massachusetts.....	920½	3,533,360.00	Wisconsin.....	10	14,400.00
Michigan.....	585	791,005.00	Wyoming.....	643	895,980.57
Minnesota.....	84	116,170.81	Alaska.....	23	103,500.00
Mississippi.....	21	37,500.00	Hawaii.....	5	8,580.00
Missouri.....	1,183	4,245,185.00	Panama.....	1	12,600.00
Montana.....			Puerto Rico.....	1	1,260.00
Nebraska.....	4	56,000.00	Unclassified.....	9,803	21,000.00
Nevada.....	15	41,400.00			
New Hampshire.....	28	33,600.00	Total.....	38,357½	60,203,358.61

^a Data unavailable.

²⁵ See the Commission's report on investment trusts and investment companies, Pt. Two (House Doc. No. 17, 76th Cong.), Ch. V, Table 111, where it is estimated that installment investment plan certificate holders at the end of 1935 represented 1.7% of all stockholders in the investment trust industry.

²⁶ Illustrating the great increase in the number of certificate holders in 1937 and thereafter, it is known that Capital Savings Plan, Inc., which had slightly less than 5,000 certificate holders on December 31, 1936 had increased that number to 20,000 at the beginning of 1939 (*Independence Shares Corporation et al. v. Deckert, et al.*, United States Circuit Court of Appeals for the Third Circuit, Nos. 7146 and 7147, March 1939, Transcript of Record, pp. 253-5).

²⁷ See Ch. IV, Sec. B, *infra*.

Chapter III

STRUCTURE AND MECHANISM OF INSTALLMENT INVESTMENT PLANS

Distinctive mechanical features set the installment investment plan apart from other types of investment vehicles. Special consideration must be given, therefore, to its technical aspects. This chapter describes generally the structure of the installment plan and the manner of its operation. Various aspects of the plan dealt with generally in this chapter are treated in more detail in subsequent chapters in connection with the problems and defects of these plans.

A. THE INSTALLMENT PLAN INDENTURE

The structure of the installment investment plan was based upon a "trust" indenture or agreement. This instrument set forth the terms of the plan and the method of its operation, prescribed the underlying securities, and defined the rights and obligations of the various parties. These parties were the "trustee," the "sponsor," and the "certificate holders." Actually, the trustee and the sponsor entered into the agreement. The certificate holder, according to the terms of the indenture, became a party to the document subsequently by acquiring a certificate.¹

B. THE TRUSTEE

The typical "trust" agreement required the trustee to receive the payments made by a certificate holder; to purchase the specified underlying securities with these funds; to credit these purchases to the account of the certificate holder; and to hold the underlying securities until liquidation was necessitated by withdrawal, cancellation, or maturity of the account of the certificate holder. The trustee performed no managerial or discretionary duties. His functions were ministerial and custodial, prescribed in detail by the installment plan agreement.

Upon receipt of the certificate holder's payments, under the terms of the usual indenture, the trustee deducted the sponsor's fees, its

¹ For example, the following clause, taken from a typical indenture, states: "This Agreement, dated as of July 15, 1935, by and between Wellington Foundation, Inc., a corporation organized under and existing by virtue of the laws of the State of Delaware (hereinafter referred to as "Foundation"), Party of the First Part; The Pennsylvania Company for Insurance on Lives and Granting Annuities, Philadelphia, Pennsylvania, a trust company duly organized under and existing by virtue of the laws of the Commonwealth of Pennsylvania, as trustee (hereinafter referred to as "Trustee"), Party of the Second Part; and the owners from time to time of Certificates in the forms hereinafter described or referred to, issued or to be issued by Foundation (hereinafter sometimes referred to as "Certificates"), who may become parties hereto by owning or acquiring Certificates (hereinafter referred to as "Holders"), Parties of the Third Part * * *" (Reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Exhibit "A," p. 1.)

own fee² and any other charges. The balance was used to purchase the underlying security specified in the indenture—either a fixed trust share, management investment company share, or a portfolio of securities. Customarily, this purchase of the underlying investment trust or investment company security was acquired to be effected from or under the direction of the sponsor company, which thereby made a profit on the sale to the trustee of this underlying security in addition to the primary service fee or sales load made by the sponsor on the installment investment plan certificate itself. This profit on the sale of the underlying security was derived from the commission or loading charge customarily added to the acquisition price of the underlying securities and hence called the “secondary sales load”.

The trustee held the investment trust shares or investment company stock or portfolio of securities, so purchased, and credited the certificate holder's account with the number of investment trust shares, or the number of participations in the portfolio of securities to which he was entitled. Fractional shares or fractional participations were also credited. This was possible since the underlying securities were not segregated for each certificate holder but were commingled. The advertised “individual trust fund” was merely a matter of bookkeeping. The entire fund, however, was treated as a separate trust fund.

Upon withdrawal, cancellation, or maturity of the account of the certificate holder, the trustee generally sold the underlying investment trust or investment company shares or participations through the same channels as those of purchase—these shares were sold to or under the direction of the sponsor company. In most plans, the certificate holder, upon withdrawal, had the right to demand the number of whole trust shares to which he was entitled, together with cash for any fraction. Withdrawal or termination fees were deducted under the terms of many plans.

The trustee was required, in accordance with the provisions of the installment plan indenture, to purchase additional investment trust shares or additional participations in the common stock portfolio with the earnings of the underlying fund.³

C. THE SPONSOR

The sponsor company was the creator of the installment investment plan as well as the distributor of installment investment plan certificates.⁴ Principally the sponsor was interested in selling the plan to the public. Its function, however, was twofold. As the creator and organizer of the installment investment scheme, it selected the trustee,

² Under the terms of some plans, the trustee's fees were required to be paid by the sponsor. See the replies to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit A, p. 69; United Fund Accumulative Certificates, Series TA, Exhibit A, p. 15; Insured Investors Series A Certificates, Exhibit A, p. 12; and Corporate Leaders Trust Certificates, Exhibit A, p. 29.

³ Some sponsors also offered plans which provided for distribution of income to certificate holders. See, for example, the reply to the Commission's questionnaire for United Fund Accumulative Certificates, Series TA, Exhibit K.

⁴ In some instances the distributor, although a separate corporation, was affiliated or indirectly related with the sponsor company. For example, see the reply to the Commission's questionnaire for Income Foundation Fund Agreements and Certificates of Trust, Table 4.

drafted the trust indenture, and chose the underlying investment trust or investment company security. As distributor of the installment investment certificates, the sponsor's activity was that of a sales organization. Incidental to this distribution activity, the sponsor undertook to "service" the installment plan certificates. This "service" consisted of "following up" delinquent certificate holders by mail or personal contact to induce them to resume payments and informing certificate holders of the status of their accounts.

Under ordinary circumstances management or supervision of the certificate holder's investment was absent from the installment investment plan, since the management, if any, was furnished by the management of the underlying fixed trust or investment company. A provision was generally inserted in the trust indenture for the substitution of the underlying investment trust or investment company security by the sponsor when certain circumstances necessitated a change, as, for example, a failure in the supply of underlying trust shares. This function was the only managerial duty of the sponsor in the installment plan proper.

In some instances the installment investment plan sponsor was also the acknowledged sponsor of the underlying investment trust or investment company. In those installment investment plans which utilized a portfolio of diversified common stocks as the underlying investment the sponsor may be regarded to have been the sponsor of a fixed investment trust or open-end management company.⁵

Realistically, management and supervision may be said to have been nonexistent in the installment investment plan proper, since a change in the underlying securities was a rare occurrence. Ministerial acts were sufficient to execute the purpose of the plan. The framework of the installment investment device established a routine for investment that was practically self-operating.

Mr. Thomas testified:⁶

Q. And in a sense you, as a sponsor company, get the investor into the hands of the trustee, with his money, and then the trustee carries on.

A. That is right, and they send the notices when payments are due, and so forth.

While the installment investment mechanism did not place any duty of management or supervision upon the sponsor company, nevertheless the function of the sponsor in fabricating the plan and thereafter in selling the plan certificates was of the utmost moment to investors. Particularly important were the sponsor's policy, decision, and conduct in the selection of the trustee and the underlying security, and in the preparation of the indenture which defined the rights of the certificate holders.

Thereafter the sponsor company's function was that of distributor. With the establishment and development of its own sales organization, the duty of training and instructing salesmen devolved upon it. The novelty and complications of the installment plan required considerable specialized knowledge on the part of a salesman. This fact accounts, in large measure, for the decrease in importance of security

⁵ This report does not discuss in detail the nature, operation, and problems of the underlying investment trusts or investment companies, which are treated in the Commission's over-all report on investment trusts and investment companies and in the supplemental report on Fixed and Semifixed Investment Trusts.

⁶ Public Examination, Financial Independence Founders, Inc., at 6244.

dealers with regard to sales of installment plan certificates. When examined on this point, Mr. Thomas testified.⁷

A. Again, however, I would like to say that the methods of selling and the presentation of the business have very materially changed since those days.

Q. Well, now, suppose you tell us a few of the things that have changed it.

A. Well, in the first place, the fact that we do not do business through security dealers has a very direct bearing upon the number of lapses.

Q. Why?

A. Because the security dealer was never vitally interested in the plan, nor did the representatives of those security dealers present the plan in the manner that the retail organization would, with the result that it wasn't well understood by the people who bought it.

Q. Did they make misrepresentations?

A. I wouldn't say that; but they just sold it more on the basis of a security, and they didn't explain fully the story as to what they wanted the person to do and why they wanted him to do it.

Mr. Barton testified to the same effect:⁸

Q. It was merely a matter of house-to-house canvassing, wasn't it?

A. To a great extent.

Q. That is practically the only way these plans can be sold, is it not?

A. No, sir; I disagree with you now.

Q. At any rate, that is the way it was sold in the early days?

A. That is the way Income Foundation was distributed in the early days. In addition to that, we made some effort to get security dealers, and some plans were sold through security dealers. That proved very unsatisfactory.

Q. For what reason?

A. Several reasons. In the first place the security business is here today and gone tomorrow. I mean, they have an issue and they sell it. They are not accustomed to selling one thing, day in and day out. Another thing, this is a highly specialized business. It is just as different from selling securities as it is from selling insurance. I don't think the average security dealer would take the trouble to analyze it and go into it deeply enough. Another objection we had, we had an unusually high lapse ratio, which was an indication that they were improperly sold. We couldn't put our finger on any specific instance, but we felt in a number of cases, particularly where they sold paid up contracts, there was a good deal of switching from one security to another, which was, of course, very objectionable to us and harmful to the contract holder.

Q. What attempts did you try to make to prevent security holders from switching?

A. We didn't have enough business distributed through that source to take any general steps to prevent it. We ceased to use that source of distribution. Wherever we had a request for liquidation we arranged to have a man call and find out why, if possible, and in a large percentage of the cases we were able to prevent the liquidation.

An important function of the sponsor company, but one which was entirely voluntary on its part, was that of "servicing" the installment plan certificate. The trustee, generally, rendered information to certificate holders who requested it, concerning the status of their

⁷ Id., at 6348.

⁸ Public Examination, Income Foundation, Inc., at 11617-9.

accounts, but the sponsor company usually undertook to communicate with delinquent certificate holders, as well as voluntarily to furnish all certificate holders with statistical reports and general information. Since one of the major advantages of the plan was supposed to be its benefit to small investors as a form of "semi-compulsory savings," this "follow-up" of delinquent accounts was important.

D. UNDERLYING INVESTMENT SECURITY OR MEDIUM

Three major forms of underlying investment security or medium were used for installment investment plans. Upon receipt of the certificate holder's payments by the installment plan trustee, they were applied depending upon the provisions of the indenture, to the purchase of shares of a specified fixed investment trust,⁹ shares of stock of a specified management investment company, usually an open-end company,¹⁰ or a diversified portfolio of securities, usually common stocks, in which the certificate holder had a proportionate participation.¹¹

The largest investment of the installment investment plans was made in fixed trust shares. Of 55 installment investment plans examined in the course of this study, 34 plans utilized fixed investment trust shares as the underlying security. This type of underlying security accounted for approximately 58% of the aggregate value of all underlying securities as at December 31, 1937. By offering fixed trust shares as the underlying medium, the organizers of the installment plan avoided any need for disclosing their investment training and experience or the lack thereof. The securities underlying the fixed trust were principally well-known common stocks, usually of high investment rating. These stocks were generally enumerated in the fixed trust indenture and could not be changed by elimination or substitution except under certain specified conditions. These stocks were purchased in a unit and against this unit were issued a designated number of fixed trust shares; the number was usually determined by dividing the unit into a thousand parts or into multiples of a thousand. The rigidity in structure and absence of management in this class of investment medium enabled the sponsor to place the appeal of the installment plan entirely upon the fact that only "blue chip" securities were contained in those investment trusts.

Shares of open-end management investment company stock were the underlying securities of 7 installment investment plans out of the 55 studied. Securities of this type accounted for 11% of the aggregate value of securities underlying installment plans as at December

⁹ The term "fixed trust" is generally used to indicate the fixed or semifixed trust. See the Commission's supplemental report on Fixed and Semifixed Investment Trusts for a discussion of this type of investment trust.

¹⁰ The important feature of this type of management investment company is the right of shareholders to require the company to redeem their shares at net asset value, less a small discount or fee. See Pt. One of the Commission's over-all report (House Doc. No. 707, 75th Cong.), Ch. II, p. 27, for a discussion of this type of investment company.

¹¹ Appendix B contains a list of installment investment plans, indicating the underlying security for each plan, the classification of the security, and the relationship of the installment plan sponsor to the depositor of a fixed trust or the issuer of an open-end management company.

31, 1937. Generally the investments of open-end companies were subject only to broad limitations and management was an important feature in these companies.

Securities in installment plans which used a diversified portfolio of stocks as the underlying investment medium amounted to about 31% of the aggregate value of underlying securities as at December 31, 1937. Generally, these securities were the same as those contained in the portfolios of fixed investment trusts—stocks of widely known companies listed on the stock exchanges. The portfolios of these installment plans were either of the “unit” type (securities deposited with the trustee in units) or of the “common fund” type (securities deposited separately in a common portfolio or fund), corresponding in general either to the fixed trust or open-end management company set-up.¹²

The unit type of portfolio consisted of a group of stocks, the composition of which was fixed by the installment plan indenture. These stocks were purchased by the installment plan trustee in a unit which was divided into a specified number of participations.¹³ As the certificate holder made payments, he was credited with the number of participations that his payments, less deductions, could buy, at the value of a participation, broadly, at the time of the payment. Four plans of the 55 examined made use of this form of investment.

The common fund type of portfolio resembled the open-end management investment company. Securities were purchased from time to time, from an eligible list of securities,¹⁴ or similar securities meeting specified conditions,¹⁵ with the payments, less deductions, of

¹² The distinction between this “unit type” which underlay the installment plan certificate and the fixed trust certificate which underlay the installment plan certificate is that in the former the certificate holder had an interest directly in the stock which composed the unit, while in the latter the installment plan certificate holder had an interest in a fixed trust share which had a unit of securities as its underlying security. Similarly, where a common fund of securities underlay the installment plan certificate the holder had a direct interest in the securities constituting the common fund while in plans where an open-end investment company security constituted the underlying security of the installment plan certificate, the holder had an interest in the open-end company stock which had in turn, as its underlying security, a portfolio of securities.

¹³ In the plan sponsored by American Participations, Inc., a “stock unit” was divided into 10,000 participations. In most other plans, the unit was divided into 1,000 or 2,000 parts.

¹⁴ Reply to the Commission's questionnaire for Independence Fund Declarations of Trust and Agreements, Item 24. The eligible list in this plan contained 86 bond issues and 105 common stocks, but investment was mainly in common stocks. (Id., Table 15 and Exhibit A)

¹⁵ For example, in the plan of Euclid Investment Trust Certificates, funds received from investors were invested in a diversified list of securities in accordance with Paragraph 4 of the trust indenture, which is as follows (reply to the Commission's questionnaire for Euclid Investment Trust Certificates, Exhibit A, p. 1) :

“The Company, with the advice of Investment Counsel, will direct the Trust Company to invest all funds available for investment in carefully selected and well-diversified securities and the same shall be held by the Trust Company, in trust. It is further provided, however, that the Investment Fund shall not be invested in the securities of any corporation :

(1) Unless at the time of such investment, the securities in which such investment is about to be made shall be regularly listed on the New York Stock Exchange, or the New York Curb Exchange, and unless sales of such securities shall have been recorded on either of said Exchanges during each of the twelve months preceding the date of such investment. (For this purpose, in the case of a reorganized corporation there may be included the record of sales of the securities of the predecessor of such reorganized corporation, and, in the case of a corporation resulting from a reorganization, consolidation, merger, or by exchange of stock, to which two or more corporations are parties, there may be included the record of sales of the securities of any one of the constituent corporations.)

(2) If through such investment an amount in excess of 20% of the Investment Fund would be or become invested in securities of any corporation or corporations whose opera-

certificate holders. Securities, cash, and other assets were commingled and participations issued in the fund. The certificate holder was credited with a proportionate number of participations as his payments went into the fund, depending on the value of a participation at that time. Ten installment investment plans were of this type.¹⁶

In a number of instances, the sponsors of the underlying investment trusts or investment companies were also the sponsors of the installment plans. In other instances, the underlying fixed trust or management investment company was sponsored by a management independent of the sponsor of the installment investment plans. The relationship between the company sponsoring the installment investment plan and the depositor or sponsor of the fixed trust or investment company was sometimes that of parent and subsidiary company or that of common ownership. The sponsor of an investment trust or company may have originated the installment plan to secure a new channel of distribution, as in the case of New York Bank Stock Plan and Insurance Stock Plan organized by Bank and Insurance Shares, Inc.; or, as was more frequently the situation, the installment plan sponsor became the sponsor of an investment trust or company to control the underlying investment fund and to secure an added source of profit.¹⁷ As previously stated, the fixed investment trust or management investment company aspect of the installment plan sponsor's activities falls within the purview of the Commission's reports on those types of investment trusts.¹⁸

tions fall primarily within any single industry. (The determination of the Company as to the classification of securities by industries shall, however, be conclusive.)

(3) If through such investment or otherwise the Company shall control more than 10% of the outstanding voting stock of such corporation.

(4) If the total capital stock of all classes issued by such corporation and outstanding, valued on the basis of the last reported sales, respectively, for each class of such stock, shall be less than \$20,000,000.

(5) If through such investment the market value of the securities of such corporation held in the Investment Fund would exceed 5% of the Investment Fund.

(6) It is further provided, however, that such securities shall bear the following Moody ratings: AAA, AA, A, BAA, BA, and B.

(7) Any security must be eliminated in case of failure to pay any dividend for a period of one year. The Trust Company reserves the right to refuse to execute any written orders for purchase or sales of securities that are not in strict accordance with this Trust Indenture. Said order or orders shall be signed by the President or Vice President, and the Secretary or the Treasurer, of the Company."

¹⁶ In one plan, National Unit Cumulative Investment Certificates, classified in this group, five closed-end management investment company stocks constituted the securities of the fund underlying the plan.

¹⁷ For example, after a short period of operation, Capital Savings Plan, Inc. acquired Independence Shares Corporation, the depositor of the underlying fixed trust shares. (See the reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Item 4.)

In some instances, the sponsor of the installment plan became the depositor of the fixed trust or the issuer of management company stock at the inception of the plan. Instances of this type with fixed trust shares underlying the plan were United Endowment Foundation Endowment Certificates, with Foundation Trust Shares, Series A, as the underlying shares, and Trust Endowment Agreements, with Trust Endowment Shares, Series A, as the underlying shares. Instances of this type of situation with open-end management company shares underlying the installment plan were Income Foundation Fund Agreements and Certificates of Trust, with Income Foundation Fund, Inc., stock as the underlying security, and Financial Security Fund Plans, with Financial Security Fund, Inc., stock as the underlying security.

¹⁸ The relationship of the sponsor of the installment investment plan to the underlying investment medium is important, however, in relation to several problems present in this field and taken up in the following chapter.

E. GENERAL FEATURES OF THE INSTALLMENT INVESTMENT PLAN

Although the installment investment plan was simple in broad outline—consisting merely of periodic purchases by a certificate holder of investment trust shares, investment company stock, or interests in a pool of common stocks through a trustee arrangement—its refinements and techniques of operation were intricate.¹⁹ The variety of fees, charges, and deductions, the distribution or reinvestment of dividends, the withdrawal, cancellation, and liquidation of certificate holders' accounts, the loan privileges, "maturity options," custodianship, optional insurance features, and the "fully-paid" features made difficult a clear understanding of the installment plan. To these complexities must be added those pertaining to the structure and operation of the particular underlying investment medium selected for the plan, together with the complications involved in purchasing, liquidating, and computing the value of participations in this underlying medium.

Admittedly, there was difficulty in enlightening the prospective purchaser of the installment investment certificates on these subjects.²⁰ Security dealers and salesmen themselves encountered difficulty in understanding the plans.²¹ In order to make clear the terms and implications of the plan, detailed and careful disclosure was required, particularly because of the type of investor to which the plan appealed. Chart 2 portrays the structure and operation of Financial Independence Founders Trustee Certificates, Series D, and graphically illustrates the intricacy of a typical installment plan. Concerning one installment investment plan, the Commission, in an opinion involving the suspension of the effectiveness of a registration statement pursuant to Section 8 (d) of the Securities Act of 1933, stated: ²²

Throughout these findings we have given ample indication of the rather high degree of intricacy of the plan of investment under registrant's certificates. From certain passages in the stipulation, which recite registrant's past sales activities in greater detail than need be stated here, it appears clearly that registrant has been in the practice of selling its securities directly to the "small investor" class, and specimens of its sales literature in the record indicate that its chief appeal has been addressed to such persons. Inherent complexity of the proposition presented, no less than the fact that the proposition is to be presented to the financially uninitiate, thus increasing the danger of confusion, should operate to increase the degree of frankness necessary in the prospectus.

Having created this complicated structure to be used by the public as an instrument for investment of funds, clearly the sponsor was under a duty to clarify every intricacy therein for the investor. Unquestionably, the sponsor company was faced with a considerable problem in this regard but the solution, like the creation of the complications, was nevertheless its own responsibility. The manner in which the sponsor fulfilled its responsibility will be indicated subsequently.

¹⁹ Public Examination, Independence Fund of North America, Inc., at 6535.

²⁰ Public Examination, Income Foundation, Inc., at 11617-8 and Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 613.

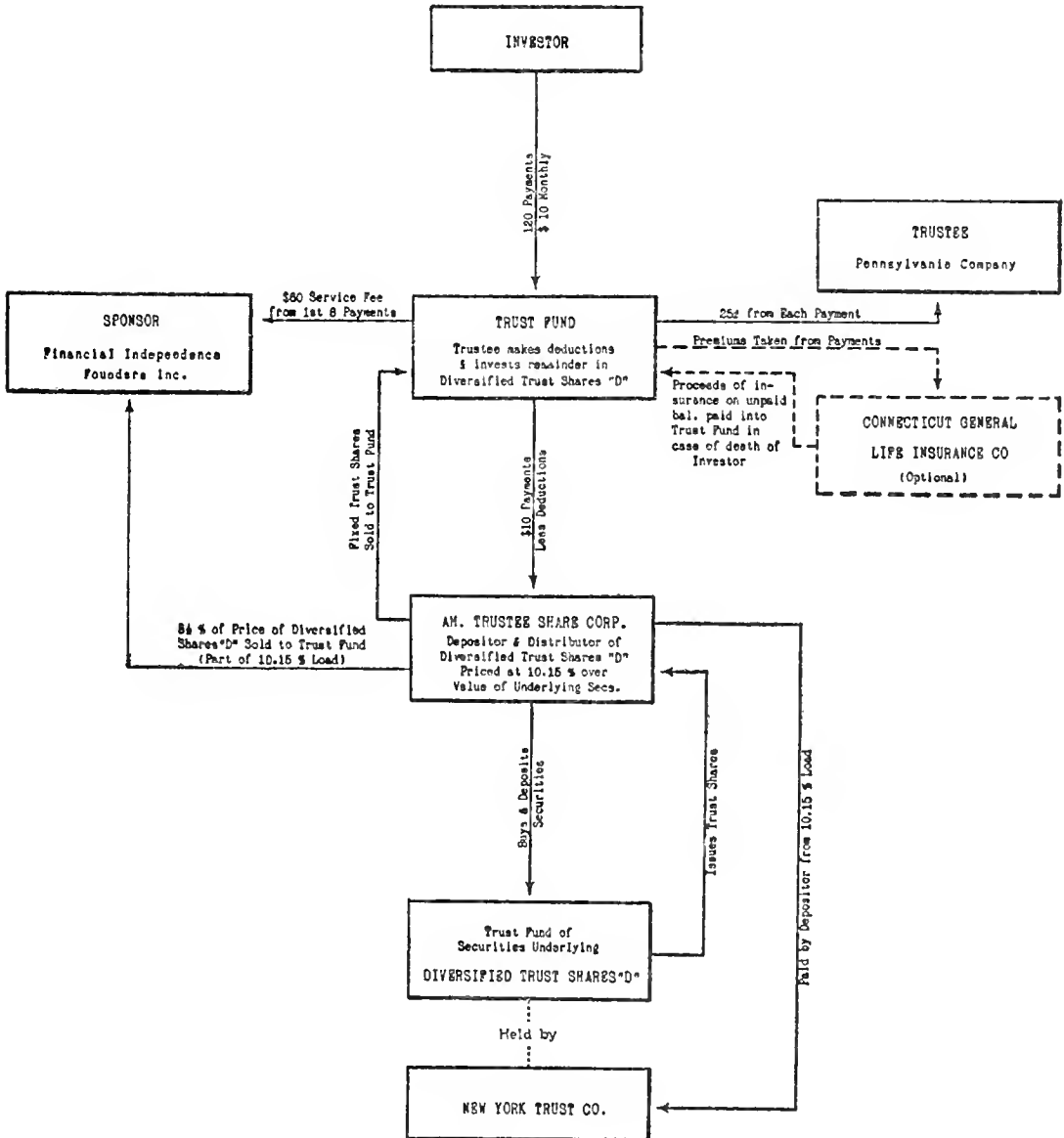
²¹ Ibid. See also Public Examination, Financial Independence Founders, Inc., at 6348.

²² *In the matter of Income Estates of America, Inc.*, 2 S. E. C. 434 (1937), at 44-5.

At this point, the remaining important structural features of the installment plan will be examined. These embrace the application, the certificate, the types of fees and charges, purchases and liquidation of the underlying security, distribution and reinvestment of dividends, withdrawals, cancellations and defaults, maturity, insurance, fully-paid certificates, and custodianship.

CHART 2

FINANCIAL INDEPENDENCE FOUNDERS, INC.
TRUSTEE CERTIFICATES, SERIES "D" PERIODIC PAYMENT PLAN^{a/}



^{a/}Source: Public Examination, Financial Independence Founders, Inc.,
Commission's Exhibit No. 561

1. The Application

The prospective investor was required to apply for participation in the installment investment plan prior to the issuance of a certificate. The application form contained the subscriber's agreement to make specified monthly payments for a certain number of months. The forms which were furnished for the fully-paid plan and for the periodic payment plan with the insurance feature contained individual characteristics in conformity with their purpose. The subscriber was

requested to give certain personal information, such as his address, occupation, employer, and business address. For the plan having provision for insurance more detailed information was requested, usually on a detachable blank to be forwarded to the insurance carrier. In this connection many forms contained a statement to the effect that the subscriber would accept a plan without insurance if insurance coverage were refused by the carrier.²³

A clause acknowledging receipt of a prospectus by the applicant was generally included. In few instances were any of the terms and conditions of the plan stated in the application form.²⁴ Reference was generally made to the indenture or certificate for terms and conditions. The investor could not look to the application form to ascertain the nature of his investment and his rights and obligations.²⁵

2. The Certificate

The installment plan certificate evidenced the status of the certificate holder as a party to the installment plan. In many instances the certificate was merely a summary of the provisions of the installment plan indenture which contained all the terms of the agreement of the parties. In other instances, the certificate contained important provisions not contained in the indenture, and reference to both documents was necessary to obtain the complete agreement. Several installment plans provided for a certificate which embodied the entire indenture in itself.²⁶

Since the certificate was sent to the subscriber after he had applied for participation in the plan and had made his first payment, reliance could scarcely be placed upon the certificate itself to impart the essential information concerning the plan. Thus, while the typical certificate contained a summary of the payments to be made, the deductions from payments, the withdrawal and maturity options and the obligations, functions and restricted liabilities of the sponsor and the trustee, the subscriber's actual source of information was the sales literature and sales talk given to him at the time of the sale.

The certificate was "authenticated" by the trustee, and the trustee usually forwarded it directly to the subscriber. Certificates were usually issued in three different series in order to distinguish among the periodic payment plan with provision for insurance, the periodic payment plan without insurance, and the fully-paid plan.²⁷ Indicated

²³ For example, the application form used by Foundation Plan Endowment Certificates contained the following statement (reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit W-1): "I will accept an Endowment Certificate without insurance if it is impossible to obtain one with insurance."

²⁴ In several cases, the application form was attached to the certificate to be issued by the sponsor or the trustee.

²⁵ With respect to installment plan certificates which were sold in interstate commerce, the installment plan sponsor was required to deliver to the purchaser a prospectus containing all the essential information concerning the installment plan in accordance with the provisions of the Securities Act of 1933.

²⁶ Independence Fund D clarations of Trust and Agreements; Trust Endowment Agreements; Trust Endowment Agreements, Type B.

²⁷ Different letters were assigned to these types of plans when different types were sponsored by the installment plan sponsor. For example, Trusteed Income Estates Certificates, Series C, issued certificates bearing the designation CN to indicate a plan with no insurance, C to indicate a plan with insurance, and CP to indicate a fully paid plan.

in the certificate were the amount and time of payments as well as the total amount agreed to be paid by the subscriber. A "maturity value" instead of a total amount payable was inserted in some certificates.²⁸ The propriety of using an arbitrary definite figure in this manner as the predicted value of the certificate holder's account (a value which might never be reached) is discussed subsequently.

3. Fees and Charges²⁹

The certificate holder's payments were subject to a variety of deductions, as were his funds after investment and the earnings thereon. The types, as well as designations of these fees and charges, varied among the plans, although it is apparent that there was much borrowing of terminology and of methods and amounts of deductions.

The primary fee of the sponsor company was deducted directly from the payments of certificate holders. This fee or "sales load," generally designated by the sponsor as a "service charge," was a fixed percentage of the total amount agreed to be paid by the certificate holder. It was generally deducted in the first year of the operation of the plan from the payments made by the certificate holder. Some plans provided for "initial fees" or "creation fees." These fees were usually not in the form of deductions but were payments made directly to the sponsor. The trustee's fees were in most instances exacted by means of deductions from the certificate holder's payments. In other cases, the trustee's compensation was paid by the sponsor company. In those plans offering an insurance provision, insurance premiums were another type of charge directly taken out of the certificate holder's payments.³⁰

Other charges were made in most plans in connection with the purchase of the underlying securities for the certificate holder. These charges, which were called the "secondary sales load," were the commissions or fees of the depositor of the underlying fixed trust shares or of the issuer of the open-end management company stock used as the underlying security in the plan. The secondary sales load was generally included in the purchase price of the underlying investment trust or investment company securities.³¹ The sponsor company of the plan either obtained a share of the secondary sales load by receiving a "commission" or "discount" from the depositor of the underlying fixed trust shares or distributor of the underlying open-end investment company shares, where such depositor or distributor was independent of the sponsor of the installment investment plan, or

²⁸ This practice was discontinued by sponsors whose plans were subject to the registration provisions of the Securities Act of 1933, after stop order proceedings instituted by the Commission in *In the Matter of Income Estates of America, Inc.*, resulted in the suspension of the effectiveness of a registration statement filed by that sponsor.

²⁹ This section is descriptive of fees and charges in general. A more detailed discussion is given later.

³⁰ Charges for insurance are not considered, in this report, to be part of the loading charge borne by installment plan certificate holders, since they represent no part of the cost of the investment instrument itself.

³¹ The secondary sales load was commonly included in the selling price of the underlying investment shares. This selling price was determined, in general, by adding to the market value of the portfolio securities odd-lot brokerage, commissions, and transfer taxes, and a certain percentage which constituted this "load."

else retained the entire secondary sales load where the sponsor of the plan was the depositor of the underlying fixed trust or distributor of the underlying open-end management investment company.

In some cases, the certificate holder's funds after investment were subject to management fees or supervisory fees. In a few plans, the trustee obtained some compensation from these funds. The earnings of the certificate holder's investment were generally subject to some type of charge. These charges consisted of supervisory fees deducted directly from earnings or loading charges placed upon re-invested earnings, similar in nature to the secondary sales load.

Upon withdrawal or redemption of the installment investment plan certificate by the holder prior to maturity, the net proceeds of the certificate holder's account was occasionally subject to withdrawal or termination fees. These were either small flat sums or fixed percentages of the balance unpaid by the certificate holder, levied upon withdrawal to assure the payment of a larger sum to the sponsor than, under the terms of the particular plan, it had received from ordinary deductions for service charges up to the time of withdrawal.

Other miscellaneous charges existed, such as fees for assignment of certificates, fees for replacement of certificates and fees for transferring from one plan to another. Taxes, legal fees, accounting expenses, and reserves for contingencies assessed on the certificate holder's funds in one plan or another, comprised the remaining important charges.

4. Sponsor's "Contributions"

Several plans provided for a small periodic contribution or bonus to be made by the sponsor to each payment of the certificate holder after a certain period of time.³² Thus, Insurance Stock Plan Contract Certificates and New York Bank Stock Plan Contract Certificates, sponsored by Bank and Insurance Shares, Inc., provided that after 12 payments were made by the certificate holder, the sponsor company would contribute 50 cents to each \$10 payment until the termination of the plan.³³ Concerning these contributions by the sponsor, Mr. Wence testified:³⁴

Q. What is the purpose of this contribution? Why was it set up?

A. That, I don't know whether I can answer, other than in my opinion to give back a proportion of the amount that was originally charged.

Q. Wasn't it a very good sales instrument—

A. Undoubtedly.

Q. The fact that the sponsor made a contribution there?

A. Undoubtedly.

³² See the replies to the Commission's questionnaire for Insured Investors Series A Certificates (Item 23); Insurance Stock Plan Contract Certificates and New York Bank Stock Plan Contract Certificates (Table 20).

³³ These plans at first provided for the issuance of \$600 certificates, payable on a 60-month basis and later \$1,000 certificates on a 100-month basis. In both cases the 50-cent contribution was made after the twelfth payment.

³⁴ Public Examination, Transcontinent Shares Corporation, at 13902.

William R. Terres, treasurer of this sponsor company, testified:³⁵

Q. That would confirm the opinion of Mr. Hare that these Plans were offered merely as a device to sell the Trust Shares, since he would be willing to pass the normal commission to the dealer back to the purchaser.

A. I would say that that would probably have been part of it.

Since contributions or bonuses were credited to the certificate holder's account only after he had made a substantial number of payments, this device operated as an inducement for the continuation of the certificate holder's program. In result, however, the certificate holder was merely being charged a greater load at the beginning of his plan than at the end.

5. Purchase and Liquidation of Securities Underlying the Installment Plan

In use in the installment plan field were various methods of computing the price of the underlying securities purchased for the certificate holder's account and for computing the liquidating value of these underlying securities upon withdrawal, cancellation or redemption of the installment investment plan certificate. Fundamentally, however, the procedure was the same among all plans and generally followed the practices customary in the purchase or redemption of fixed trust shares or open-end management company stock.

In purchasing the underlying fixed trust shares, the trustee credited the certificate holder with the number of trust shares, including fractional amounts, that his payments, less deductions, would buy at the asked price of the trust shares on the same or the following day. The fractional amounts were usually credited to the third decimal place.

The certificates for fixed trust shares themselves were issued against a fixed number of underlying portfolio securities. The asked price of the trust shares, that is, the acquisition price charged certificate holders making payments on the plan, was generally calculated by adding a percentage, which has already been described as the secondary sales load, to the market value of the portfolio securities of the fixed trust and the cost of odd-lot brokerage, commissions, taxes and other expenses.³⁶ The resulting figure represented the price of an entire unit. This sum was thereupon divided by the number of trust shares in which the unit was divided to determine the price of a single share. This price was usually adjusted to the next higher fraction of a dollar—generally one-eighth or one-twentieth of a dollar.

This was the customary practice of depositors of fixed trusts and was adopted as well by the installment plan sponsor which had set up its own underlying fixed trust. The installment plan sponsor which had arranged for a portfolio of common stock purchased directly in a unit as the underlying medium, used the same procedure to determine the purchase price or acquisition price of a participation

³⁵ Id., at 13903.

³⁶ See the Commission's supplement report on Fixed and Semifixed Investment Trusts for more detailed discussion.

in the portfolio stock unit.³⁷ There were exceptions, however, in that some plans using the unit type of underlying portfolio securities added no secondary sales load to the price of a participation.³⁸ The sponsor's sales load was taken in a single fee in the latter cases which covered both the primary sales load on the installment investment plan certificate and the secondary sales load on the underlying security.

The market value of the portfolio securities was determined according to quoted prices on the exchanges. Generally, the closing sales price of the previous day was taken and if there were no closing sales price, the closing asked price was taken.³⁹ Under the terms of some plans the opening sales price of the same day was selected, and if no such price was available the opening asked price was used.⁴⁰

Upon withdrawal, the liquidating asset or portfolio value of an installment investment certificate holder's account was determined by multiplying the number of trust shares, including fractional shares, credited to his account, by the bid price of the fixed trust shares at the time of liquidation.⁴¹ The bid price of the underlying fixed trust shares, that is, the liquidation price, was also based upon the market value of the underlying securities, except that odd-lot brokerage, commissions, and taxes, constituting the proportionate cost of selling the portfolio securities, were deducted.

Thus the spread between the bid and asked price embraced approximately the cost of buying and selling the underlying securities and the loading charges of the fixed trust depositors. The same procedure was followed in those plans purchasing portfolio stocks directly in a unit in order to obtain the value of a participation in this unit for purposes of liquidation.

Generally, some method of adjustment was employed which placed all certificate holders on an equal footing as regards accumulated dividends and undistributed income. The most common method was to compute the proportionate amount of such accumulations and undistributed income per share or participation based on the total shares or participations issued for each unit and to require an equal sum to be added to the price of underlying shares or participations.⁴²

The acquisition price of open-end management investment company stock was similarly computed. The market value of the portfolio securities was determined and odd-lot brokerage, commissions,

³⁷ Replies to the Commission's questionnaire for American Participation Certificates (Item 25) ; Hamilton Trust Share Certificates, Exhibit I (1), p. 5 (but see Exhibit A, par. 15) ; and Corporate Leaders Trust Certificates (Item 25).

³⁸ Replies to the Commission's questionnaire for American Participation Certificates (Item 23) ; Hamilton Trust Share Certificates (Item 23) ; and Euclid Investment Trust Certificates (Item 23).

³⁹ Reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit A (p. 50).

⁴⁰ Reply to the Commission's questionnaire for Trust Endowment agreements (Item 25).

⁴¹ In most cases, the installment plan subscriber was entitled to receive the actual trust shares themselves plus cash for any fractional shares upon withdrawal, but this privilege was rarely exercised, and most withdrawals were in cash.

⁴² This equalization reserve is to be distinguished from the reserve account created in some fixed trusts to "equalize" dividends. Those reserves were created to supply funds upon which the sponsor of the trust could draw to maintain the dividend rate at a fixed percentage when income fell below this percentage. (See the Commission's supplemental report on Fixed and Semifixed Investment Trusts for a detailed discussion.)

taxes, other expenses, and the issuer's loading charges were added to obtain the acquisition value of the assets of the open-end company.⁴³ The acquisition value of each share of stock was then calculated by dividing the number of outstanding shares into the value of the entire fund.⁴⁴ For purposes of liquidation, the price was based upon the market value of the portfolio securities less similar costs incident to the sale.

Installment plans making use of direct participations in a portfolio of securities of the common fund type computed the value of a participation in the entire fund in a manner similar to the open-end investment companies.⁴⁵

6. Reinvestment and Distribution of Dividends

Under most installment investment plans the dividends or other distributions received on the securities underlying the installment investment plans were accumulated. Cash dividends were reinvested in the same manner as the certificate holder's payments and credited to the account of the certificate holder. Stock dividends, scrip, stock warrants, and other earnings were sold by the trustee and the proceeds were similarly invested. Some sponsors offered plans under which the certificate holder was given the option to receive the distributions on his investment, but this type of plan does not appear to have been urged upon the investor.⁴⁶

⁴³ The securities underlying the fixed trust shares or unit type of portfolio purchased on behalf of the installment plan certificate holders were usually common stocks, listed on important stock exchanges and consisted of the so-called "blue chips" or "market leaders." This type of security also generally formed the portfolio of the open-end management company. In some instances, however, the stock purchased was not listed on any exchange or generally negotiated, and the value used in place of market value was the appraised value of the stock.

⁴⁴ The initial value of a participation was calculated in an arbitrary manner, since at the time of the origin of a plan there were no participations as yet outstanding. The sponsor usually assigned an arbitrary value to the initial block of participations issued. For example, in the case of National Unit Cumulative Trust Fund Certificates, first deposits were credited on the basis of one participation in the fund for each \$10 applicable to investment (payment less fees and charges). Thereafter, each payment received was represented by such number or fractional number of participations as shown by the quotient of the amount applicable to investment divided by the then current value of a participation.

⁴⁵ See the replies to the Commission's questionnaire for Euclid Investment Trust Certificates Exhibit A, par. 9; Independence Fund Declaration of Trust and Agreements (Item 25); United Fund Accumulative Certificates Series T A (Item 32).

⁴⁶ See for example the reply to the Commission's questionnaire for Trusteed Income Estates Certificates, Original Series. The indenture covering this installment plan contains the following provision (id. Exhibit A, sec. 6.02): "As soon as conveniently possible after moneys representing distributions on Trust Shares have been received by the Trustee, it shall pay to each Founder, who shall not, in his application for a Certificate, have authorized the Trustee to invest the same, a sum equal to the amount, carried to the second decimal place, distributable with respect to the number of Trust Shares noted in the Trust Fund Account of such Founder, less any deductions provided for in this Agreement."

The application, however, contained a printed provision expressly authorizing the reinvestment of all distributions in additional trust shares (id., Exhibit W) and in giving the history and policy of the plan, the following statement is made (id., Item 12): "In the Monthly Deposit Plan all income from the investor's trust property is reinvested in additional shares, thus applying the compounding principle to earnings."

In the event of the revocation by the certificate holder of the trustee's authority to reinvest distributions, the sponsor could terminate the certificate holder's plan. (Id., Exhibit A, sec. 6.05; see also the reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Exhibits A and W-1.)

The expense of making trifling periodic distributions of income to installment investment certificate holders apparently did not warrant its use. The installment plan sponsors made the most of what may appear to be a practical difficulty and emphasized the reinvestment of dividends as one of the advantageous features of the plan. Furthermore, a secondary sales load was obtained by the sponsor upon the reinvestment of dividends in many plans. This may have been the sponsor's inducement for presenting to subscribers the advantage of what the sales literature called "compound earnings."

7. Withdrawals or Redemptions, Cancellations, and Defaults

The terms of the installment investment plan commonly provided that a certificate holder might withdraw from the plan or have his certificate redeemed at any time. Upon such withdrawal or redemption, the certificate holder's account was liquidated and the net proceeds turned over to him. In some instances, the certificate holder was entitled to the physical delivery in hand of the amount of securities purchased and credited to his account.⁴⁷ The fees which were deducted upon the termination of the plan have been mentioned in a preceding section.⁴⁸ In several plans where provision was not made for the deduction of specific termination or withdrawal fees, and where the certificate holder's entire payments for the first months of the plan were not taken for service fees, the terms of the plan provided that if withdrawal occurred before the company received its entire service fee, the unpaid portion of the service fee was to be deducted from the net proceeds.⁴⁹

Withdrawal terminated the certificate holder's interest in the plan. Provision was made in many instances, however, for partial withdrawal. Under this provision, a certificate holder could withdraw the bulk of the liquidating or asset value of his account after he had made a specified number of payments—generally sufficient payments to insure receipt by the sponsor of its service fee—without terminating his plan.⁵⁰

Most investment plans provided that in the event of delinquency in payments by the certificate holder for a stated period of time, usually one year, the sponsor or trustee might cancel the certificate and remit to the certificate holder any equity due to him.⁵¹ Under some plans cancellation and liquidation were compulsory after de-

⁴⁷ This privilege was generally accorded the certificate holder in those plans utilizing investment trust shares or management company stock as the underlying medium, and not in those plans with an underlying portfolio of stocks whether of the unit or common fund type. Withdrawing certificate holders practically always liquidated their accounts for cash.

⁴⁸ See *supra*, subsec. 3.

⁴⁹ Replies to the Commission's questionnaire for Fundamerican Trusteed Certificates, Item 22 (a); Foundation Plan Endowment Certificates, Exhibit A, p. 53; United Endowment Foundation Inc. Endowment Certificates, Exhibit A, p. 56.

⁵⁰ *Ibid.* See also the replies to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Item 22 (a); and Trusteed Income Estates Certificates, Series C, Item 22 (a).

⁵¹ Replies to the Commission's questionnaire for United Fund Accumulative Certificates, Series T A, Exhibit A, p. 6; Future Requirements Plan Investment Certificates, Exhibit D-4; and Trusteed Income Estates Certificates, Series C, Exhibit D.

fault in payments by the certificate holder for the stated period of time.⁵²

8. Maturity

The completion of payments by the certificate holder was generally termed the "maturity" of the plan. When such completion date arrived, the certificate holder was entitled to exercise certain "maturity options." These options gave the subscriber the privilege of receiving in cash the asset value of his account or of leaving the account in the trustee's hands until some future time, generally upon payment of additional charges.⁵³ Under most plans, instead of payment in cash of the asset value of the account, the subscriber could request his shares of the underlying securities plus cash for any fractional amount of such property.⁵⁴ Under other plans, these options included a privilege to continue making payments.⁵⁵

9. Provision for Insurance

Many sponsors offered the subscriber a plan that contained provision for insurance. The insurance policy under this provision was of the group coverage, renewable term insurance type, sometimes called a creditors group, one year renewable term, nonparticipating policy. The policy insured the life of the certificate holder for an amount equal to the unpaid balance on his certificate. In the event of death, the proceeds of the policy were paid to the trustee, which applied the money in the same manner as certificate holder's payments would have been applied. Thus, the payment of all fees and charges was assured. The beneficiary, named by the certificate holder, received in effect a fully-paid certificate.

The insurance premiums were generally deducted monthly from payments made by the certificate holder. The amount of the premium gradually decreased, over the life of the plan, since the premium was based upon the balance due under the plan. The certificate holder, in general, paid no more than the cost of such insurance as fixed by the insurance company.

There was no physical examination, although the right to an examination was sometimes reserved. The information given by the subscriber in the application blank furnished the grounds for acceptance or rejection by the insurer.

10. Fully-Paid Certificates

The fully-paid investment certificate merely represented the lump sum investment by the certificate holder in the underlying investment trust or investment company security or fund of portfolio securities selected by the installment plan sponsor. Although the fees and

⁵² Replies to the Commission's questionnaire for Fundamerican Trusteed Certificates, Exhibit A, p. 29 (one year); and United Endowment Foundation Endowment Certificates, Exhibit A, p. 54 (one year).

⁵³ Public Examination. Income Foundation, Inc., at 11628-9, and the reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Exhibit D.

⁵⁴ *Ibid.*

⁵⁵ Reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Exhibit D.

charges deducted from this lump sum payment were less than those of the periodic payment plan, they were nevertheless considerable and generally greater than those that investment in the underlying medium acquired in the open market would have entailed.

11. Custodianship

Several plans had provisions for a custodian, as well as a trustee. Under these plans the custodian had physical possession of the underlying securities,⁵⁶ or had physical possession of shares evidencing the participations in the underlying medium.⁵⁷ The resulting structure presented an even more complicated picture than the ordinary plan. Thus, the set-up of Independence Fund Participation Agreements provided for the issuance of participations in the underlying investment trust shares of the plan, namely, North American Trust Shares, 1953. The portfolio securities underlying the fixed trust shares were held by Guaranty Trust Company of New York; the fixed trust shares were held by the installment plan trustee, City Bank Farmers Trust Company; and the participations were held by the installment plan custodian, Empire Trust Company. Instead of the ordinary "trust on a trust" relationship, this plan resulted in a triple layer of trusts.

12. Loans

Under some plans provision was made whereby certificate holder could obtain loans from the sponsor company with his net investment as collateral.⁵⁸ Other plans provided that the sponsor would endeavor to secure loans for certificate holders by making arrangement with some lending agency.⁵⁹

⁵⁶ Reply to the Commission's questionnaire for Accumulating Investment Plan Subscription Certificate (Item 14). Under this plan, the custodian had the duties generally performed by the trustee under the ordinary plan; the trustees were individuals whose only real function was the holding of title to the underlying securities. Cf. the reply to the Commission's questionnaire for Income Foundation Fund Agreements and Certificates of Trust (Item 14).

⁵⁷ Reply to the Commission's questionnaire, Independence Fund Participation Agreement (Items 2 and 14). The sponsor's succeeding plan eliminated the custodian from the arrangement.

⁵⁸ Reply to the Commission's questionnaire for United Fund Accumulative Certificates, Series T A (Item 28).

⁵⁹ Reply to the Commission's questionnaire for National Trustee Fund Share Certificates (Item 28).

Chapter IV

PROBLEMS AND DEFECTS IN CONNECTION WITH THE CREATION AND OPERATION OF INSTALLMENT IN- VESTMENT PLANS

A. FEES, LOADS, CHARGES, AND OTHER COSTS

One of the major problems in the installment investment plan field arises in connection with the actual cost of the plan to the investor. Other problems concerning fees, loads, and charges find their source in the variety and types of charges and in the methods of computing and deducting them. Certain practices engaged in by sponsor companies, resulting in profits to them and increased costs to investors, are distinct aspects of the same general subject. These problems are, for the most part, unique in the investment trust industry and require a more specialized analysis than would otherwise be the case.

1. Types and Amounts of Fees, Loads, and Charges

In the succeeding section, the amounts of the total loading charges of installment investment plans are set forth and discussed. That problem is naturally the most vital one in this subject from the standpoint of the investor. However, an adequate exposition necessitates a description of the various types of fees, loads, and charges, together with some discussion of their range and frequency.

a. PRIMARY SALES LOAD OR SERVICE FEES

Under most plans the sponsor company derived a substantial, if not the major, portion of its profits from the "sales load" charge on the sale of the certificate, the so-called "service fee." This load or fee was deducted directly from the investor's monthly payments by the trustee and turned over to the sponsor, or retained by the sponsor in those plans in which payments were made to it. Although the typical service fee was a fixed percentage of the total amount agreed to be paid on the certificate, it was generally exacted in the first six or seven months of the 10-year period of the plan. In but few plans was this load or fee spread over the entire 120 months—and in most of these instances the greater portion of the service fee was obtained by the sponsor in 12 months or less.¹ As a consequence, only a small portion of the cer-

¹ Several plans provided for equal proration of the sales load or service fee throughout the life of the plan. In these cases, a termination fee was assessed upon the funds of a certificate holder who withdrew from the plan before maturity. The sponsor was thus eventually enabled to obtain the equivalent of the service fee charged by other sponsors whether or not the certificate holder withdrew from the plan.

tificate holder's payments was actually invested for him in the underlying securities until the second or third year. (This matter is treated separately in a subsequent section in connection with particular problems raised by this manner of deducting the service fee.) Thus the early exaction of the fee by the sponsor was attended by loss of dividend-earning potentialities during the first years of the plan. More important perhaps is the problem raised by the high rate of withdrawals and defaults that occurred in the first years of the installment plan, since premature lapsing at that time was practically invariably accompanied by loss to the investor, who was entitled, not to the amount which he paid, but to the value of the underlying securities, if any, which had been purchased with the portion of his payments remaining after deduction of the sales load. In some plans the first six months' installment payments were retained entirely by the sponsor as its sales load, so that no portion of the investors' payments for that period was invested in the underlying securities. In those cases the investor who withdrew from the plan at the end of six months received nothing back from the plan.

In this connection it must be remembered that even where the investor made payments for more than six months and portions of his payments were invested in the underlying securities, upon withdrawal he might not receive an amount equal to the amount which he paid in. Not only were the primary sales load and other loads and charges deducted from his payments and an amount less than that which he had paid on his certificate invested in the underlying securities but he was entitled only to the asset value of his certificate—substantially the market value of the portfolio securities underlying the security which underlay the installment plan certificates. If the market price of these portfolio securities declined after the time of his payments, the asset value of the certificate would be less than the amount which he paid in.² The market price of the portfolio securities would have to rise to an extent to equal or exceed the amount of sales load, fees, and charges deducted from the payments made by the investor, before the investor upon withdrawal would receive an amount equal to the amount which he paid on the installment certificate. If the market price of the portfolio securities continued to rise, the certificate holder would receive upon withdrawal an amount greater than the amount paid by him on his certificate up to that time.

The sponsor's sales load or "service charges" ranged from approximately \$60 to \$144 for the \$1,200 unit. The wide variation in service fees is attributable to the fact that the sponsors of plans with low service charges derived additional profits from other types of fees. The total loading charges borne by investors, as will be seen, did not vary so widely.³

² Dividends and earnings would in some degree increase the amount credited to the certificate holder.

³ See Sec. A, 2, of this chapter.

The frequency distribution of this sales load or service charge for 35 comparable plans is as follows:⁴

Amount of primary sales load :	Number of plans
\$60 to \$69-----	12
\$70 to \$79-----	11
\$80 to \$89-----	1
\$90 to \$99-----	5
\$100 to \$109-----	--
\$110 to \$119-----	2
\$120 to \$129-----	2
\$130 to \$139-----	1
\$140 to \$149-----	1
	<hr/> 35

b. INITIAL FEES

Twelve plans provided for a "creation fee" or "initial fee" either in lieu of sales load or service fee or in addition to the sales load or service fee.⁵ These were initial payments made in addition to the required installments under the plan, earmarked for the sponsor company and paid to it in lump sum at the time of subscription or in installments in the first months of the plan. The purpose of the creation fee apparently was the dissociation of the sponsor's charges from those portions of the certificate holder's payments that were to be applied to the purchase of underlying securities and, hence, the conspicuousness of those charges. This type of charge was devised to meet the objection that certificate holders did not realize the amount of fees deducted by the sponsor from the payments until, perhaps, the investor desired to withdraw his investment or redeem his certificate. To the extent, however, that there were other fees and charges, not equally emphasized, the investor might have received the impression that the "creation fee" was the only fee to be paid to the sponsor or the only deduction from his payments. Nor did these initial fees remove the objection to the exaction of the sponsor's fees in the early period of the installment plan. However, the requirement of an initial fee, in addition to the regular payments, operated to a certain extent to reach a greater proportion of subscribers in a higher financial or income bracket than those reached by the ordinary plan.⁶ The payment of \$20 or more as the investor's initial payment instead of the ordinary \$5 or \$10 payment has been asserted to be of merit in limiting the distribution of the installment plan to investors in the higher income brackets and in retarding the sale of the plan to those who were not

⁴ See Table 5, *infra*, for the names of plans and amounts of service fees. Twelve plans, having service fees but not using a basic unit of \$1,200, were not included in the above frequency table. The fees of these plans ranged from \$6 to \$162; the amounts payable under the minimum certificates of these plans ranged from \$600 to \$1,800.

⁵ See Table 5, *infra*.

⁶ This problem is discussed in greater detail in Sec. B, *infra*.

financially suited for a fluctuating investment in common stocks with the necessity of making regular payments over an extended period of time.

The amounts of the initial fees varied from \$10 to \$90. This variation is attributable to the same reason as the variation of sales loads or service fees—the derivation by the sponsor of profits from other types of fees or loads. None of these fees taken singly gives any indication of the amount of the total charges borne by the installment investment plan subscriber.

The amounts of initial fees in the various plans which provide for these fees are listed below, together with the total amount payable and the primary sales load, if any, charged in addition on the certificate:

Name of plan	Amount payable	Initial fee	Primary sales load ^a
Trust Endowment Agreements.....	\$1, 215	\$15	-----
Trust Endowment Agreements, Type B.....	1, 280	15	\$65
Corporate Leaders Trust Certificates.....	1, 210	10	75
Corporate Leaders Trust Fund Certificate, Series A.....	1, 200	60	36
Euclid Investment Trust Certificates.....	1, 260	60	-----
Independence Fund Declarations of Trust and Agreements.....	1, 290	90	-----
Assured Independence Plan Trusteed Certificates.....	1, 210	10	78
National Unit Cumulative Investment Certificates.....	1, 260	60	24
Standard Trust Foundation Agreements.....	1, 250	25	55
Thrift Investment Certificates of Agreement.....	1, 560	60	-----
Insurance Stock Plan Contract Certificates.....	1, 030	30	6
New York Bank Stock Plan Contract Certificates.....	1, 030	30	6

^a For the complete list of the amounts and types of fees levied in these plans see Table 5, infra.

In some of these cases the initial fee was not required to be paid in addition to the regular installment payment but portions of this fee were deducted from the first payments as they were made.⁷ In the plans represented by National Unit Cumulative Investment Certificates and Independence Fund Declarations of Trust Agreements, the initial fees of \$60 and \$90, respectively, were payable in \$10 installments in addition to the regular installment payments of \$10.⁸ In these latter cases the total outlay required each month of the investor was a minimum of \$20. These are the plans in which the requirement of the initial fee was said to deter the sale of the plan to those who probably would not be able to continue to make payments over a long period of time. In the plans under which Euclid Investment Trust Certificates and Thrift Investment Certificates of Agreement were sold, the entire initial fee of \$60 was apparently required to be paid immediately.⁹ In these cases the objection to the

⁷ This was the procedure in the following plans: Corporate Leaders Trust Fund Certificates, Series A, Standard Trust Foundation Agreements, Insurance Stock Plan Contract Certificates, and New York Bank Stock Plan Contract Certificates.

⁸ Replies to the Commission's questionnaire for National Unit Cumulative Investment Certificates and Independence Fund Declarations of Trust and Agreements (Item 23).

⁹ Replies to the Commission's questionnaire for Euclid Investment Trust Certificates (Exhibit K) and Thrift Investment Certificates of Agreement (Item 23).

sale of plans to a marginal class of investor is even more completely met. However, the payment of so large an amount in proportion to the monthly installment required gives rise to the other objections in connection with the practice of exacting "service fees" in the early period of the plan which has been referred to previously and will be discussed in greater length in a succeeding section.

c. WITHDRAWAL FEES

Withdrawal fees on termination were of two kinds, ostensibly assessed with different purposes in view, although both served as a deterrent to the investor's withdrawal from the plan and the liquidation of his account and both added to the sponsor's profits. Under some installment investment plans, a fixed amount was deducted from the proceeds of the subscriber's investment if he withdrew from the plan prior to the completion of the agreed payments.¹⁰ This type of fee was commonly not large and presumably was intended to cover the cost of liquidation and withdrawal. Another point of view, however, suggests that this charge was merely a penalty for withdrawal, designed to restrain the certificate holder from terminating his payments and liquidating his account before completion of the plan.

Another type of withdrawal fee existed in those plans in which the sponsor's fee was equally prorated over the entire period of the plan and not appropriated by the sponsor in the first months of the plan.¹¹ In order to assure to itself payment of a fee comparable in amount to the service fee charged in the usual plan despite early discontinuance of the plan by a subscriber, the sponsor devised an arrangement whereby at liquidation a fee was deducted from the proceeds of the investor's account. This sum gradually decreased each month as payments were made by the certificate holder and regular fees were actually received by the sponsor. The advantage claimed for this method of extracting what was the equivalent of the "service fee" lay in the immediate investment of the major part of each of the subscriber's payments. The earning power of the investor's funds was thus employed at the inception of the plan. Nevertheless, the other objection to the levying of the service fee in the first months of the plan, that is, the loss to the investor in the event of early withdrawal, was not eliminated.¹² In fact, in at least one instance the loss would be even greater than the loss sustained under the usual method of making immediate deductions.¹³

¹⁰ For example, a withdrawal charge of \$6 was deducted upon the withdrawal of a certificate holder before maturity in a plan sponsored by Financial Independence Founders, Inc. (reply to the Commission's questionnaire for Financial Independence Founders Trustee Certificates, Series D, Exhibit D). A \$5 withdrawal charge was assessed in the plan sponsored by American Participations, Inc. (Reply to the Commission's questionnaire for American Participations Certificates, Item 23.)

¹¹ Replies to the Commission's questionnaire for Trust Endowment Agreements, and Income Foundation Fund Trust Certificates (Item 23).

¹² This problem is discussed in greater detail in Sec. A, 3, of this chapter.

¹³ Public Examination, Income Foundation, Inc., at 11699.

d. MANAGEMENT FEES

While the so-called management or supervisory fees were generally deducted from the earnings derived upon the underlying portfolio stocks, several plans provided for management fees which were direct deductions from the certificate holders' principal fund. Thus, on a basic unit of \$1,200, General Reserve Corporation Trust Fund Certificates provided for a management fee of \$28.23,¹⁴ Independence Fund Declarations of Trust and Agreements provided for a \$60 management fee,¹⁵ and United Fund Cumulative Certificates, Series TA provided for a management fee of \$82.81.¹⁶ In these plans the direct underlying investment medium was a portfolio of securities of the common fund type. Some discretion and latitude in the purchase and sale of securities was permitted in these plans. The management fee, therefore, was somewhat similar to the charges for management and supervision levied by the managers of a management investment company.

In some instances, however, a management fee was assessed although it bore no relationship to any actual management of the certificate holders' fund. In fact, the "management" for which this fee was charged was stated to be the maintenance of the certificate holders' account and the servicing in connection therewith.

Concerning this point, Louis Wence, secretary of Transcontinent Shares Corporation, testified as follows:¹⁷

Q. It has no management duties in connection with that, and yet it gets a fee of 50 cents a month for the first year.

A. The 50 cents additional deduction on the first year is used by the sponsor in payment of commissions to the dealer who originally sold the plan.

Q. In other words, the term "management fee" is really an erroneous term. There is no management connected with it, is there? It is simply part of the initial fee?

A. Well, there is quite a lot of detail and records kept on each one of these accounts.

Q. But there still wasn't any actual management of the underlying property?

A. No.

¹⁴ Securities Registration Statement for General Reserves Corporation, File No. 2-3357, filed with the Securities and Exchange Commission July 25, 1936, at 5a. In this plan the management fee was expressed as $\frac{1}{8}$ of 1% of the cost value of the fund of the certificate holder deducted quarterly.

¹⁵ Reply to the Commission's questionnaire for Independence Fund Declarations of Trust and Agreements (Item 23). In this plan the management fee was 50 cents per month for a \$1,200 unit deducted from the fund regardless of the number of payments made or whether or not they were made when due.

¹⁶ Reply to the Commission's questionnaire for United Fund Cumulative Certificates, Series TA (Item 23). In this plan the management fee was expressed as "a monthly investment fee of one-fifteenth of one percent ($\frac{1}{15}$ of 1%) per month of the market value of this certificate."

¹⁷ Public Examination, Transcontinent Shares Corporation, at 13907-8.

Q. There really couldn't be?

A. No.

Q. The trust shares were deposited with the trustee, and that is all there is to it. They stayed there?

A. Yes.

While the management fee deducted by the sponsor of Independence Fund Declarations of Trust and Agreements may properly be deemed a "management" fee, the sponsor also deducted a management fee in another plan, Independence Fund Declarations of Trust. While part of this latter fee was devoted to the cost of management, a substantial portion provided for the payment of selling costs. Strictly, therefore, this fee could not be considered entirely a management fee. Mr. Simonson testified:¹⁸

Q. What are the management fees?

A. Under the Declaration of Trust the management fees are approximately—well, under the Declaration of Trust the management fees are three-quarters of one per cent on the value of the fund taken out of income quarterly. One-quarter of one per cent quarterly. Under the Declaration of Trust and Agreement, the management fee is 50 cents a month per \$10 account.

Q. And how much for a \$20 account?

A. A \$25 is the next denomination. That is \$1.25.

* * * * *

Q. So it is 5 per cent for management over a ten-year period?

A. Yes.

Q. On the periodic payment plan, whereas it is three-quarters of one per cent where it is fully paid?

A. That is correct.

Q. How do you account for such a large difference? Is that because you have to pay the salesman something out of the management fee on the declaration of trust and agreement?

A. No; we do not pay the salesman anything out of the management fee on the declaration of trust and agreement.

Q. But you do out of the other one?

A. Out of the declaration of trust the dealer or branch office gets 25 percent of the management fee.

Q. Why should anybody get a split for distribution or sales effort when you have a charge in there for management?

* * * * *

A. I say we have a management, or rather, we view the management in two categories. One is the absolute investment management, and the other is the management of that account and the servicing by the dealer, the constant contact with the client and reporting to him the status of his fund, seeing that he receives periodical reports, answering questions in regard to it, and the like. We feel that is a very sound basis for compensating the dealer for maintaining his interest in the account after it is established.

¹⁸ Public Examination, Independence Fund of North America, Inc., at 6627.

While Mr. Simonson included in the term "management" the servicing of the certificate holder's account and the "management of the client," these functions cannot be distinguished from those for which the ordinary "service fee" was presumably charged.

e. SECONDARY SALES LOAD

The fees previously described may be considered the primary load obtained by the sponsor company. A second charge was paid by the certificate holder in connection with the purchase of the underlying security by the trustee on behalf of the certificate holder. The sponsor derived additional revenue when this purchase was made. In fact, in some cases the major portion of the sponsor's revenue came from this source.

This additional load imposed upon the certificate holder was the commission or selling charge generally calculated in the purchase or acquisition price of the investment trust shares or management company stock underlying the plan. This commission or sales load was generally a fixed percentage of the value of the bottom portfolio securities included in the selling price of the fixed trust shares or the shares of management company stock. It may be observed that this was the general practice of all depositors or issuers of these types of investment trust securities.

The installment plan sponsor participated in this sales load by arrangement with the depositor or issuer of the underlying investment trust or investment company security. The sponsor's participation in the load on the underlying investment trust or investment company security is considered by the sponsors as the equivalent of the ordinary commission or discount paid to dealers and distributors. This commission or discount was not passed on to the installment plan investor but was retained by the sponsor of the installment investment plans and constituted a second selling load or fee—hence termed "secondary sales load."

Even where the installment plan sponsor was also depositor or issuer of the underlying securities, a full secondary sales load was charged on the underlying securities purchased by the sponsor for the certificate holder's account, and the entire secondary sales load was usually retained by the sponsor of the plan. A similar secondary loading charge was even placed on the beneficial participations in two plans utilizing a portfolio of common stock as the underlying investment medium.

Table 3 indicates the sponsor's participation in the secondary sales load in those plans using fixed trust shares or shares of management company stock deposited or issued by a company having no relationship or affiliation with the installment plan sponsor. Also shown in this table is the amount and percentage of the secondary sales load.

TABLE 3.—*Sponsor's participation in secondary sales load of independent fixed trusts and management investment companies*^a

Sponsor	Depositor of fixed trust or management investment company	Secondary sales load		Sponsor's share (percent)
		Percent	Amount	
Benjamin Franklin Foundation, Inc.	T. I. S. Management Corporation.....	9½	\$95.31	90
Financial Independence Founders, Inc.	American Depositor Corporation ^b	8½	88.00	64
Do.....	American Trustee Share Corporation ^c	9¼	93.98	64
Fundamerican Corporation.....	Fundamental Group Corporation.....	8½	87.00	57
Income Estates of America, Inc.....	T. I. S. Management Corporation.....	9½	95.30	90
Income Foundation, Inc.....	Independence Shares Corporation.....	9	90.70	66
Do.....	Bullock Fund, Ltd.....	8¾	89.30	57
Do.....	Nation Wide Securities Co.....	9½	96.32	53
Independence Fund of North America, Inc.	Distributors Group, Inc. ^d	4	41.54	None
Do.....	Distributors Group, Inc. ^e	9½	96.30	84
Individual Assured Estates, Inc....	United Endowment Foundation, Inc....	8½	82.70	52
Insured Investors, Inc.....	Trustee Standard Shares, Inc.....	9½	87.75	60
Investors Independence Corporation.	Independence Shares Corporation.....	9	92.48	55
Lexington Foundation, Inc.....	do. ^f	9	91.65	55
Do.....	T. I. S. Management Corporation ^g	3	32.76	66
Do.....	do. ^h	9½	95.31	90
Liberty Thrift Foundation, Inc.....	do.....	9½	95.31	90
National Assured Estate, Inc.....	Distributors Guild, Inc.....	8	88.28	53
National Trustee Fund, Inc.....	Independence Shares Corporation.....	6	67.01	(ⁱ)
Standard Foundations of America, Inc.	Trustee Standard Shares, Inc. ^j	5	56.24	97

^a Percentages are calculated on the net investment of the certificate holder in the portfolio securities.

^b The underlying fixed trust listed here was Corporate Trust Shares used by the sponsor for its plans sold prior to February 1932. Under the terms of the installment plan indenture Financial Independence Founders, Inc., could designate the person through whom the trust shares were to be purchased. The sponsor designated Seward W. Eric and Company, an investment firm closely affiliated with the sponsor, which firm received the participation in the secondary sales load from this depositor and the subsequent depositor, American Trustee Share Corporation. Later, the sponsor designated itself as the dealer through whom the trustee was to purchase the underlying securities (reply to the Commission's questionnaire for Financial Independence Founders Trustee Certificates, Series D, Items 5 and 6).

The secondary sales load was partly a fixed sum for each share and partly a percentage during the period when these shares were used for the installment plan. The amount indicated is estimated on the basis of average loads during this period.

^c The underlying fixed trust was Diversified Trustee Shares, Series D, used by the sponsor as underlying security for plans sold after February 1932.

^d The underlying fixed trust was North American Trust Shares, 1953, underlying Independence Fund Participation Agreements. The secondary sales load indicated above is estimated on the basis of average loads during the period when it was purchased for the installment plan.

^e The underlying fixed trust was Cumulative Trust Shares underlying Independence Fund Trust Certificates which were sold after July 1931.

^f The sponsor used Independence Trust Shares as underlying securities for plans sold by it prior to December 1934.

^g The sponsor used Trusteed Industry Shares as underlying security for plans sold after December 1934. In Future Requirements Plan Investment Certificates FC and FD sold prior to December 1936, a discount of 6% from the secondary sales load of 9½% was allowed to certificate holders until the amount of discount equaled the service fee of \$72.

^h The sponsor obtained the indicated participation under the plans sold by it after December 1936.

ⁱ The sponsor claimed that it purchased shares on the open market at varying prices above the bid price and hence the participation in the secondary sales load is not determinable. This load was 9% but certificate holders were given a discount of 3%.

^j The secondary sales load was 9.9%. However, the plan provided for a "bonus" every sixth payment after the eleventh payment. These bonuses, totaling \$44, were deducted from the secondary sales load.

It is apparent from these figures that almost without exception the major part of the secondary sales load was taken by the installment plan sponsor. In many instances, this share amounted to as much as 90%. In Independence Fund Participation Agreements the sponsor turned over its entire discount or commission to the investor, but the sponsor discontinued the sale of these plans shortly after creation.¹⁹ As indicated three other plans provided for a partial participation for the investor in the discount or commission obtained by the sponsor.²⁰

The secondary sales load imposed in plans where the sponsor was also the depositor or issuer of the underlying security, or was affiliated with the depositor or issuer, is indicated in Table 4.

TABLE 4.—*Sponsor's participation in secondary sales load in plans with affiliated fixed trusts or management investment companies*

Sponsor	Name of depositor of fixed trust or management investment company	Secondary sales load		Sponsor's share (per cent)
		Percent	Amount	
Capital Savings Plan, Inc.	Independence Shares Corporation....	9	\$91.65	66
Corporate Equities, Inc.	Corporate Equities, Inc.	9 $\frac{6}{10}$	105.00	100
Foundation Plan, Inc.	United Endowment Foundation, Inc.	8 $\frac{1}{10}$	83.25	60
North American Securities Co.	Commonwealth Investment Co.	7	72.62	100
Transcontinent Shares Corporation..	Transcontinent Shares Corporation...	8 $\frac{7}{10}$	81.08	100
United Endowment Foundation, Inc.	United Endowment Foundation, Inc..	8 $\frac{1}{10}$	83.25	100

The two plans having a fund of portfolio stocks as the immediate underlying investment medium and providing for secondary sales loads, were Corporate Leaders Trust Fund Certificates, Series A²¹ and Insured Investors, Series B Certificate.²² On the \$1,200 minimum certificate of Corporate Leaders Trust Fund Certificates, Series A, the sales load of 5% totaled \$51.97. Although this load was characterized as a "service fee," it was a percentage computed in the acquisition price of a participation in the fund and is indistinguishable from the customary secondary load. The \$1,000 certificate of Insured Investors Series B Certificates had a secondary load amounting to \$75.88. This secondary sales load, described as a "diversification fee," was 8% of the net amount invested.

Of 51 plans for which data are available, 38 provided a procedure by which the sponsor obtained a portion of its revenue from the secondary sales load.²³ On a typical \$1,200 unit this secondary sales

¹⁹ These plans were sold from May 1930 to July 1931 (reply to the Commission's questionnaire for Independence Fund Participation Agreements, Item 17).

²⁰ These plans were Future Requirements Plan Investment Certificates FC and FD, 6% ; National Trustee Fund Certificates, 3% ; Standard Trust Foundation Agreements, \$44 out of \$100.24.

²¹ Securities Registration Statement for Corporate Leaders of America, Inc., File No. 2-1777, filed with the Securities and Exchange Commission November 25, 1935, Items 25 and 28.

²² Securities Registration Statement for Insured Investors, Inc., File No. 2-2843, filed with the Securities and Exchange Commission February 3, 1937, Item 36.

²³ See Table 5 for a list of plans having secondary sales load and the amounts of such loads.

load or fee amounted to approximately \$90. This load or fee was, therefore, relatively important to the sponsors of the plans. Its existence in the installment investment plan field created a serious problem, for it presented to the investor the problem of accurately computing and comprehending the amount of load and fees that he was actually required to pay. This problem will be taken up separately in a succeeding section of this chapter.²⁴

f. TRUSTEE'S FEES

Compensation paid to the installment plan trustee for its services was another important cost incurred in the installment investment plan. In 31 plans the fees of the trustee were deducted directly from the certificate holder's payments as they were made.²⁵

In 16 plans the trustee's compensation was paid by the sponsor. Only four plans provided for payment out of earnings.²⁶ Practical uniformity as to the amount of the trustee's fees existed among those plans in which direct deductions from payments were made. The charge most frequently levied was $2\frac{1}{2}\%$ of the total sum payable on the certificate. This amounted to \$30 for the typical \$1,200 certificate, paid at the rate of 25¢ a month. The trustee's fees for the early plans²⁷ were slightly higher, ranging from 3% to 4%.

g. INSURANCE PREMIUMS

Insurance premiums were properly not part of the cost of the installment investment plan. The investor received insurance protection under a group term insurance policy at rates fixed by the insurance company. Most sponsors claimed that they derived no profit from the insurance charges.²⁸

²⁴ See Sec. A, 4, of this chapter.

²⁵ See Table 5 for a list of those plans with this type of trustee's fees and the amount of these fees.

²⁶ In two of these plans the trustee was assured of its fees in the event that earnings failed to materialize, by an agreement on the part of the sponsor to advance these fees in anticipation of earnings. If the certificate holder withdrew from the plan before any earnings were received, the fees advanced or payable to the trustee were deducted from the liquidated proceeds of the certificate holder's account (reply to the Commission's questionnaire for Trust Endowment Agreements, Item 23 (b), and Securities Registration Statement for Corporate Equities, Inc., File No. 2-1292, filed with the Securities and Exchange Commission February 15, 1935, prospectus filed March 19, 1935, p. 51).

²⁷ Thus Financial Independence Founders Shares Certificates, Q Series, provided for a trustee's fee of 3%; Income Foundation Investment Contract, Plans A, B, and C, had a trustee's fee of 4%. In subsequent plans created and distributed by the sponsors of these plans the trustee's fee was the uniform $2\frac{1}{2}\%$.

²⁸ Individual Assured Estates Endowment Trust Certificates provided for standard, ordinary life insurance for those certificate holders who desired such insurance. The insurance was placed with California-Western States Life Insurance Company of Sacramento, California, at its usual rates in a face amount equal to the amount payable under the installment plan certificate. Premiums were paid out of the monthly installment payments and the sponsor company received commissions from the insurance company for each policy. For the period 1933 to 1935 these commissions amounted to \$4,442 (reply to the Commission's questionnaire for Individual Assured Estates Endowment Trust Certificates, Item 26).

As to profits derived by sponsors from the payment of excess premiums to the sponsor, see Sec. A, 5, *infra*.

Nevertheless, the insurance premium as a deduction from the certificate holder's payments ²⁹ substantially reduced the balance invested for the certificate holder and increased the percentage loading charge on the invested funds. Hence the premiums had a direct bearing on fees, loads, and charges borne by the installment plan investor. The following section on "Amount of Total Loading Charge" deals, among other things, with this aspect of the subject.³⁰ The insurance policy, generally described as a "creditor's group life policy, one-year renewable term, nonparticipating," was issued by the insurance company to the sponsor company as "creditor," payable to the trustee in the event of the assured's death.³¹

The range and frequency in amount of insurance premiums for a \$1,200 unit over the ten-year period is indicated below: ³²

Amount of insurance premium:	Number of plans
\$40 to \$49-----	3
\$50 to \$59-----	2
\$60 to \$69-----	6
\$70 to \$79-----	14
	<hr/> 25

Although the premiums ranged from \$42.84 to \$79.20, the greatest number of plans had premiums that came to \$78 or \$79. The average cost of insurance amounted to \$69 on the basis of a \$1,200 certificate.

The premiums in most plans were based upon a single monthly rate adopted as an average rate for all certificate holders. At the inception of these plans an arbitrary monthly premium per \$1,000 of insurance was agreed upon. Thereafter this rate might be reduced in accordance with the experience of the insurance company and the average age of certificate holders then insured. Thus, the

²⁹ In the plan sponsored by Financial Security Fund, Inc., insurance premiums were paid in addition to the regular monthly installment payments. Hence these premiums had no effect on the amount of the net investment or the loading charge. The investor paid premiums amounting to \$63.24 for decreasing term insurance covering the unpaid balance on a \$1,200 certificate (Securities Registration Statement for Financial Security Fund, Inc., File No. 2-3503, filed with the Securities and Exchange Commission November 4, 1937, Amendment filed December 10, 1937, Item 46 (f) and (g)). Another plan provided for an option pursuant to which insurance premiums could be paid in addition to regular monthly installment payments (reply to the Commission's questionnaire for Hamilton Trust Share Certificates, Exhibit I, p. 8).

³⁰ Table 6 in the same section discloses the amounts of the insurance premiums for those plans with insurance provisions.

³¹ The following is a list of the insurance companies and the number of plans for which they acted as insurers:

Name of insurance company:	Number of plans
Connecticut General Life Insurance Co., Hartford, Conn.-----	17
United States Life Insurance Co., New York, N. Y.-----	8
Actua Life Insurance Co., Hartford, Conn.-----	3
Lincoln National Life Insurance Co., Fort Wayne, Ind.-----	2
Business Men's Assurance Co., Kansas City, Mo.-----	2
Bankers Union Life Insurance Co., Denver, Colo.-----	2
Continental Assurance Co., Chicago, Ill.-----	1
Continental Life Insurance Co., St. Louis, Mo.-----	1
Atlas Life Insurance Co., Tulsa, Okla.-----	1

³² These figures are derived from Table 6, *infra*, which is based on the replies to the questionnaire and on the securities registration statements. The questionnaire material generally covers the period only up to 1935. Later figures might show a 10% to 20% reduction in many of these insurance premiums.

monthly rate of \$1.10 per \$1,000 of insurance was adopted for a number of plans but was later reduced to 90 cents or less.³³

Since the average age of certificate holders was the basis for determining the rate of insurance charges, those certificate holders older than that age gained the advantage of a favorable rate at the expense of younger certificate holders.

Life insurance covering the unpaid balance of the certificate holder's agreed payments was strongly emphasized by the sponsor in its sales campaigns as greatly beneficial to the certificate holder in that he was protected against the noncompletion of his investment program in the event of death. While no figures are available to furnish a basis of comparison between the cost of insurance to certificate holders in the installment plan and the monthly rates of individual term insurance according to the usual method of computing the group base rate, it is believed that the difference is not great. However, while such insurance assured the investor of a paid-up certificate for his estate or beneficiary at his death, it also assured the sponsor company and the trustee of the payment of their fees if the certificate holder died. In view of the fact that the certificate holder was under no obligation to continue the payments from which the sponsor and the trustee derived fees, the payment of insurance premiums that guaranteed to them the collection of their fees in the event of the death of the certificate holder, benefited to some extent the sponsor company and the trustee.

II. DEDUCTIONS FROM DIVIDENDS

The dividends on the certificate holder's invested funds were generally subject to one or more charges.³⁴ The major charge of this kind was made in connection with the automatic reinvestment of dividends for the certificate holder and by reason of the secondary sales load which was included in the price of the underlying security purchased for the certificate holder. In 33 plans out of 47, this secondary sales load was imposed on the certificate holder's reinvested dividends.

The range and frequency of such deductions were as follows:

Secondary sales load (percent of amount invested) :	<i>Number of plans</i>
3 to 3.9_____	2
4 to 4.9_____	2
5 to 5.9_____	1
6 to 6.9_____	2
7 to 7.9_____	2
8 to 8.9_____	9
9 to 9.9_____	14
10 _____	1
	<hr/> 33

³³ At least 20 plans were known to have commenced the sale of plans with insurance premiums deducted at the monthly rate of \$1.10 per \$1,000 of insurance. In practically every case, the insurance rate was eventually lowered to some extent.

³⁴ Table 7, *infra*, lists the various deductions from distributions in 47 installment investment plans. Only 6 plans imposed no load of any kind on distributions.

In addition to or in the absence of these fees, supervisory or maintenance fees were deducted from the dividends received on the underlying securities of the certificate holders' fund. These fees were paid to various parties associated with this fund, such as the depositor of the fixed trust, investment counsel employed by the sponsor, the trustee of the installment plan, the trustee of the underlying fixed trust, or the installment plan sponsor itself. In 12 plans, these fees were expressed as a fixed percentage of the dividends received. In 20 plans, the fees were a fixed percentage of the market value or cost value of the underlying fund, deducted from dividends monthly, quarterly, semiannually, or annually.

The range and frequency of those fees expressed as a percentage of the dividends received on the underlying security were as follows:

Fees on distributions (percent of annual dividends) :	<i>Number of plans</i>
20 on excess over 6-----	2
2½-----	1
5-----	5
5 plus 15 to 25 on excess over 6-----	1
6-----	1
9-----	1
25-----	1
	<hr/> 12

The substantial nature of these fees is apparent. The range and frequency of those fees which were expressed as a percentage of the underlying fund were as follows:

Fees on distributions (percent of annual value of fund) :	<i>Number of plans</i>
1/15 of 1-----	2
1/4 of 1-----	4
1/2 of 1-----	9
3/4 of 1-----	1
1-----	2
2-----	1
6-----	1
	<hr/> 20

These fees were also substantial. For example, in plans where the supervisory fee was 1/2 of 1%, if dividends amounting to 5% on the invested funds were paid, the supervisory fee would come to 10% of those dividends. If less dividends were distributed, the percentage would be proportionately greater.

1. MISCELLANEOUS FEES AND EXPENSES

Minor sums for purposes such as transferring from one plan to another, assignment of certificates, replacement of certificates, partial withdrawal, and reinstatement after default were frequently provided for in the installment investment plan. Some plans charged small sums for furnishing information and reports to certificate holders concerning their accounts. Default fees were sometimes deducted from the funds of the certificate holder who failed to make his payments regularly and promptly.

The certificate holder's fund was also liable for variable expenses such as taxes, legal fees, and accounting charges. Generally, a provision in the installment plan indenture provided that the trustee was to be reimbursed if any reasonable or necessary expenses were incurred in connection with the underlying fund.

2. Amount of Total Loading Charges

The total fees and charges borne by the installment plan investor consisted of deductions from the certificate holder's payments or from his invested funds and deductions from the distributions received on the underlying investment. Since deductions from distributions were expressed as a percentage of an indeterminate amount, they are considered separately. Some deductions from the certificate holder's principal were also variable in practice, being a percentage of the market value of the underlying fund. For purposes of comparison in this section, however, the value of the fund in these cases has been considered as having undergone neither appreciation nor depreciation. Table 5 shows the amount of the load borne by the certificate holders in 51 installment investment plans.³⁵ This table discloses the amounts of initial fees, service fees and secondary loading charges, trustees' fees and the total load for each plan. The net amount invested for the certificate holder and the percentage of the total load to this amount and to the amount paid in is then presented. It appears from these figures that the average total load of all plans was 15.56% of the net amount to be invested if all required payments were made.

Table 6 lists the insurance costs for 28 plans offering this provision and shows how the deduction of insurance premiums affects the total net amount invested for the certificate holder. Insurance premiums were in all these cases taken out of the payments made by certificate holders,³⁶ leaving the sum to be invested substantially smaller than in the noninsurance plan. While the secondary load of these plans was, therefore, slightly less in amount than that in those plans without insurance, the percentage of fees and charges to the net amount invested (not including the insurance costs) was greater. This percentage, as an average in these 28 plans, was 16.58%. With the insurance costs included, it amounted to 23.77%.

Based upon the average percentage of fees, shown by these tables, the approximate fees and charges of a theoretical, average \$1,200 plan without insurance amounted to approximately \$160, leaving \$1,040 for actual investment. A theoretical, average \$1,200 plan with insurance bore a load of approximately \$160 for fees and charges³⁷ and \$69 for insurance premiums and left \$971 for actual investment.

³⁵ This table is based upon information as of December 31, 1935 for those plans filing replies to the questionnaire and as of December 31, 1937 for the remainder. Data after December 31, 1935 are derived from the securities registration statements filed with the Securities and Exchange Commission under the Securities Act of 1933.

³⁶ Cf. *supra*, note 29.

³⁷ The amount of the secondary sales load of a plan without insurance was less than the load in the same plan with provision for insurance since there was less money to be invested. However, the average amount of the total load of the 29 plans with insurance equals approximately the amount of the total load of the 51 plans without insurance. The reason for this result is that several plans with a relatively low load did not offer a plan with insurance.

TABLE 5.—*Deductions from payments made under 51 installment investment plans, monthly periodic payment type*

Name of plan	Total amount payable	Sponsor's creation or initial fee	Sponsor's sales load	Trustee's fee	Management fee of sponsor, depositor, or issuer	Secondary sales load ^a	Total loading charges ^b	Net amount invested	Fees as percentage of amount payable	Fees as percentage of amount invested
American Participation Certificates.....	\$1, 200		\$144. 00	\$30. 00			\$174. 00	\$1, 026. 00	14. 50	16. 95
Benjamin Franklin Foundation Trust Certificates.....	1, 200		72. 00	30. 00		\$95. 31	197. 31	1, 002. 69	16. 44	19. 67
Capital Savings Plan Contract Certificates.....	1, 200		60. 00	30. 00		91. 65	181. 65	1, 018. 35	15. 14	17. 84
Trust Endowment Agreements..	1, 215	\$15. 00		"		105. 00	120. 00	1, 095. 00	9. 87	10. 96
Trust Endowment Agreements, Type B.....	1, 280	15. 00	^d 65. 00	"		105. 00	185. 00	1, 095. 00	14. 45	16. 89
Corporate Leaders Trust Certificates.....	1, 210	10. 00	75. 00	"			85. 00	1, 125. 00	7. 02	7. 55
Corporate Leaders Trust Fund Certificates, Series A.....	1, 200	60. 00	36. 00	"		51. 97	147. 97	1, 052. 03	12. 33	14. 07
Euclid Investment Trust Certificates.....	1, 260	60. 00		58. 00			118. 00	1, 142. 00	9. 37	10. 33
Financial Independence Founders Share Certificates, Deposit Series.....	1, 200		96. 00	"		^e 88. 00	184. 00	1, 016. 00	15. 33	18. 11
Financial Independence Founders Share Certificates, T Series.....	1, 200		96. 00	"		^e 88. 00	184. 00	1, 016. 00	15. 33	18. 11
Financial Independence Founders Share Certificates, Q Series.....	1, 200		60. 00	36. 00		102. 00	198. 00	1, 002. 00	16. 50	19. 76
Financial Independence Founders, Inc., Certificates, Series D.....	1, 200		60. 00	30. 00		93. 98	183. 98	1, 016. 02	15. 33	18. 11
Financial Security Fund Plan.....	1, 200		117. 00	"			117. 00	1, 083. 00	9. 75	10. 80
Foundation Plan, Inc., Endowment Certificates.....	1, 200		90. 00	"		83. 25	173. 25	1, 026. 75	14. 44	16. 87
Fundamerican Trusteed Certificates.....	1, 200		60. 00	30. 00		87. 00	177. 00	1, 023. 00	14. 75	17. 30
General Reserves Corporation Trust Fund Certificates, Series A.....	1, 200		90. 00	"	\$28. 23		118. 23	1, 081. 77	9. 85	10. 93
Hamilton Trust Share Certificates.....	1, 200		120. 00	"			120. 00	1, 080. 00	10. 00	11. 11
Trusteed Income Estates Certificates, Original Series.....	1, 200		72. 00	30. 00		46. 73	148. 73	1, 051. 27	12. 39	14. 15
Trusteed Income Estates Certificates, Series C.....	1, 200		72. 00	30. 00		95. 30	197. 30	1, 002. 70	16. 44	19. 67
Income Foundation Fund Agreement & Certificates of Trust.....	1, 800		162. 00	45. 00			207. 00	1, 593. 00	11. 50	13. 00
Income Foundation Certificates, Plans A, B, and C.....	1, 200		60. 00	42. 00		90. 70	192. 70	1, 007. 30	16. 06	19. 13
Income Foundation Investment Contracts, Plan E.....	1, 200		60. 00	30. 00		89. 30	179. 30	1, 020. 70	14. 94	17. 57
Income Foundation Investment Contracts, Plan G.....	1, 200		60. 00	30. 00		96. 32	186. 32	1, 013. 68	15. 53	18. 38
Independence Fund Participation Agreements.....	1, 200		120. 00	"		41. 54	161. 54	1, 038. 46	13. 46	15. 56
Independence Fund Trust Certificates.....	1, 200		60. 00	30. 00		96. 30	186. 30	1, 013. 70	15. 53	18. 38

See footnote at end of table.

TABLE 5.—*Deductions from payments made under 51 installment investment plans, monthly periodic payment plan—Continued*

Name of plan	Total amount payable	Sponsor's creation or initial fee	Sponsor's sales load	Trustee's fee	Management fee of sponsor, depositor, or issuer	Secondary sales load	Total loading charges	Net amount invested	Fees as percentage of amount payable	Fees as percentage of amount invested
Independence Fund Declarations of Trust and Agreements	\$1, 290	\$90.00	-----	\$36.00	\$60.00	-----	\$186.00	\$1, 104.00	14.42	16.85
Individual Assured Estates, Inc., Endowment Trust Certificates	1, 200	-----	\$66.26	30.98	-----	\$82.70	179.94	1, 020.06	15.00	17.64
Insured Investors Series A Certificates	1, 000	-----	^h 25.00	"	-----	87.75	112.75	887.25	11.28	12.71
Insured Investors Series B Certificates	1, 000	-----	^h 20.00	31.50	-----	75.88	127.38	872.62	12.74	14.60
International Investment Trust Units	800	-----	100.00	"	-----	-----	100.00	700.00	12.50	14.29
Investors Independence Trust Share Certificates	1, 200	-----	80.00	"	-----	92.48	172.48	1, 027.52	14.37	16.79
Future Requirements Plan Investment Certificates, FB	1, 200	-----	60.00	30.00	-----	91.65	181.65	1, 018.35	15.14	17.84
Future Requirements Plan Investment Certificates, FD	1, 200	-----	72.00	30.00	-----	32.76	134.76	1, 065.24	11.23	12.65
Lexington Foundation Contract Certificates, Series LN	1, 200	-----	72.00	30.00	-----	95.31	197.31	1, 002.69	16.44	19.68
Liberty Thrift Foundation Trust Certificates	1, 200	-----	72.00	30.00	-----	95.31	197.31	1, 002.69	16.44	19.68
Assured Independence Plan Trust Certificates	1, 210	10.00	78.00	"	-----	88.28	176.28	1, 033.72	14.57	17.05
National Trustee Fund Certificates	1, 200	-----	72.00	48.00	-----	62.65	182.65	1, 017.35	15.22	17.95
National Trustee Fund Contract Certificates	1, 200	-----	72.00	30.00	-----	67.01	169.01	1, 030.99	14.08	16.39
National Unit Cumulative Investment Certificates	1, 260	60.00	24.00	36.00	-----	-----	120.00	1, 140.00	9.52	10.53
North American Bond & Share Certificates	960	-----	96.00	"	-----	64.00	160.00	800.00	16.67	20.00
Commonwealth Fund Trust Certificates	1, 200	-----	60.00	30.00	-----	72.62	162.62	1, 037.38	13.55	15.68
Accumulating Investment Plan Subscription Certificates	600	-----	26.95	15.05	-----	52.12	94.12	505.88	15.69	18.65
Prudential Assured Estates Trust Certificate	1, 200	-----	78.00	30.00	-----	94.74	202.74	997.26	16.90	20.33
Standard Trust Foundation Agreements	1, 250	25.00	55.00	"	-----	^h 56.24	136.24	1, 113.76	10.90	12.23
Thrift Investment Certificates of Agreement	1, 560	60.00	-----	"	-----	75.00	135.00	1, 425.00	8.65	9.47
Insurance Stock Plan Contract Certificates	1, 030	30.00	6.00	25.00	-----	^h 37.08	98.08	931.92	9.52	10.52
New York Bank Stock Plan Contract Certificates	1, 030	30.00	6.00	25.00	-----	^h 37.08	98.08	931.92	9.52	10.52
Union Investment Trust Series A-K	800	-----	96.00	^o 8.75	-----	-----	104.75	695.25	13.09	15.07
United Endowment Foundation, Inc., Endowment Certificates	1, 200	-----	90.00	"	-----	83.25	173.25	1, 026.75	14.44	16.87

See footnote at end of table.

TABLE 5.—*Deductions from payments made under 51 installment investment plans, monthly periodic payment plan—Continued*

Name of plan	Total amount payable	Sponsor's creation or initial fee	Sponsor's sales load	Trustee's fee	Management fee of sponsor, depositor, or issuer	Secondary sales load	Total loading charges	Net amount invested	Fees as percentage of amount payable	Fees as percentage of amount invested
United Fund Accumulative Certificates, Series TA.....	\$1,200		\$55.00	*	\$82.81		\$137.81	\$1,062.19	11.48	12.97
Wellington Foundation Trust Certificates.....	1,200		132.00	\$30.00			162.00	1,038.00	13.50	15.61
Average percentages.....									13.39	15.56
Approximate total fee and net amount invested for theoretical \$1,200 plan ¹							160.00	1,040.00		

* Does not include adjustments to higher fractions and miscellaneous profits from trading, taking positions, revolving funds, etc., which in some cases amounted to from 2 to 2½%.

^b Does not include expenses and liabilities to which the fund itself may be subjected, such as taxes, counsel fees, and accountant's fees.

^c Payable from distributions.

^d This is in the nature of a reserve fund in which the investor may participate under certain conditions.

^e Trustee's fee paid by sponsor.

^f Trustee's fee is 1% of value of fund, levied quarterly on basis of ¼ of 1% of average market value in each quarter. This figure is based on assumption that fund will not fluctuate.

^g Estimated.

^h This amount takes into account refunds by sponsor.

¹ Based on average total loading charge.

TABLE 6.—*Deduction from payments made under 28 installment investment plans, monthly periodic payment type with provision for decreasing term insurance*

Name of plan	Total amount payable	Insurance premium amount	Total fees and charges amount ^a	Net amount invested	Insurance premium as per cent of—		Total fees and charges as per cent of—		Total fees and charges and insurance premiums as percent of amount invested
					Amount payable	Amount invested	Amount payable	Amount invested	
American Participations Certificates.....	\$1,200	\$63.70	\$174.00	\$962.30	5.31	6.62	14.50	18.08	24.70
Benjamin Franklin Foundation Trust Certificates.....	1,200	67.86	191.39	940.75	5.66	7.21	15.95	20.34	27.55
Capital Savings Plan Contract Certificates.....	1,200	65.18	176.27	958.55	5.43	6.80	14.69	18.39	25.19
Trust Endowment Agreements.....	1,215	79.08	120.00	1,015.92	6.51	7.78	9.88	11.81	19.59
Corporate Leaders Trust Certificates.....	1,210	78.60	85.00	1,016.40	6.50	7.73	7.02	8.36	16.09
Corporate Leaders Trust Fund Certificates, Series A.....	1,200	77.23	144.14	978.63	6.44	7.89	12.01	14.73	22.62
Financial Independence Founders Trustee Certificates, Series D.....	1,200	60.72	178.80	960.48	5.06	6.32	14.90	18.62	24.94

^a Excluding insurance premiums.

TABLE 6.—*Deductions from payments made under 28 installment investment plans, monthly periodic payment type with provision for decreasing term insurance—Continued*

Name of plan	Total amount payable	Insurance premium amount	Total fees and charges amount ^a	Net amount invested	Insurance premium as per cent of—		Total fees and charges as per cent of—		Total fees and charges and insurance premiums as per cent of amount invested
					Amount payable	Amount invested	Amount payable	Amount invested	
Foundation Plan, Inc., Endowment Certificates.....	\$1,200	\$78.54	\$167.29	\$954.17	6.55	8.23	13.94	17.53	25.76
Fundamerican Trusteed Certificates.....	1,200	79.08	170.76	950.16	6.59	8.32	14.23	17.97	26.29
Hamilton Trust Share Certificates.....	1,200	55.52	120.00	1,024.48	4.63	5.42	10.00	11.71	17.13
Trusteed Income Estates Certificates, Original Series.....	1,200	78.60	145.32	976.08	6.55	8.05	12.11	14.89	22.94
Trusteed Income Estates Certificates, Series C.....	1,200	78.00	190.49	931.51	6.50	8.37	15.87	20.45	28.82
Income Foundation Fund Agreements and Certificates of Trust.....	1,800	127.80	207.00	1,465.20	7.10	8.72	11.50	14.13	22.85
Income Foundation Investment Contracts, Plan D.....	1,200	79.20	172.94	947.86	6.60	8.36	14.41	18.25	26.61
Income Foundation Investment Contracts, Plan F.....	1,200	79.20	179.43	941.37	6.60	8.41	14.95	19.06	27.47
Independence Fund Participation Agreements.....	1,200	42.84	159.89	997.27	3.57	4.30	13.32	16.03	20.33
Independence Fund Trust Certificates.....	1,200	42.84	185.87	971.29	3.57	4.41	15.49	19.14	23.55
Independence Fund Declarations of Trust.....	1,290	42.84	186.00	1,061.16	3.32	4.04	14.42	17.53	21.57
Insured Investors Series A Certificates.....	1,000	60.00	107.35	832.65	6.00	7.21	10.74	12.89	20.10
Insured Investors Series B Certificates.....	1,000	60.00	117.32	822.68	6.00	7.29	11.73	14.26	21.55
Investors Independence Trust Share Certificates.....	1,200	55.92	167.93	976.15	4.66	5.73	13.99	17.20	22.93
Future Requirements Plan Investment Certificates FC, FD.....	1,200	71.40	132.96	995.64	5.95	7.17	11.08	13.35	20.52
Lexington Foundation Contract Certificates.....	1,200	64.33	191.62	944.05	5.36	6.81	15.97	20.30	27.11
Liberty Thrift Foundation Trust Certificates.....	1,200	78.60	190.42	930.98	6.55	8.41	15.87	20.45	28.89
National Trustee Fund Contract Certificates.....	1,200	78.60	171.16	950.24	6.55	8.27	14.26	18.01	26.28
Commonwealth Fund Trust Certificates.....	1,200	69.03	158.11	972.86	5.75	7.10	13.18	16.25	23.35
United Endowment Foundation, Inc., Endowment Certificates.....	1,200	78.54	167.36	954.10	6.55	8.23	13.95	17.53	25.76
Wellington Foundation Trust Certificates.....	1,200	78.60	162.00	959.40	6.55	8.19	13.50	16.89	25.08
Average percentages.....	-----	-----	-----	-----	5.80	7.19	13.34	16.58	23.77
Approximate fees of average \$1,200 plan with insurance.....	1,200	69.00	160.00	971.00	-----	-----	-----	-----	-----

^a Excluding insurance premiums.

The total loading charges for the 51 plans considered in Table 5 ranged from 7.55% of the net amount invested to 20.33%. The frequency distribution of the total loading charges for these plans is indicated in the following table:

Total loading charge (percent of amount invested) :	<i>Number of plans</i>
7 to 7.9-----	1
8 to 8.9-----	—
9 to 9.9-----	1
10 to 10.9-----	7
11 to 11.9-----	1
12 to 12.9-----	4
13 to 13.9-----	1
14 to 14.9-----	4
15 to 15.9-----	4
16 to 16.9-----	7
17 to 17.9-----	7
18 to 18.9-----	6
19 to 19.9-----	6
20 to 20.9-----	2

51

Thirty-one plans had a total loading charge that was above the average of 15.56%, ranging as high as 20.33%. Fourteen plans had total loading charges from 18% to 20% of the net amount invested.

The total load for the 28 plans having provision for insurance ranged from 8.36% of the net amount invested to 20.45%, not including the cost of insurance. The frequency distribution of these loads was as follows:

Total loading charge as of amount invested, not including cost of insurance (percent) :	<i>Number of plans</i>
8.4-----	1
11.0 to 11.9-----	2
12.0 to 12.9-----	1
13.0 to 13.9-----	1
14.0 to 14.9-----	4
15.0 to 15.9-----	—
16.0 to 16.9-----	3
17.0 to 17.9-----	5
18.0 to 18.9-----	5
19.0 to 19.9-----	2
20.0 to 20.9-----	4

28

Seventeen plans had a load higher than the average of 16.58%.

These figures, however, are not weighted with respect to the actual distribution of plans to the public. Many plans with loads much higher than the average, ranging from 17% to 20%, were those most

widely sold to the public. Thus, actively sold plans with high loads were as follows:

Benjamin Franklin Foundation Trust Certificates, with a load of 19.67% in the noninsurance type and 20.34% in the insurance type (27.55% including insurance premiums).³⁸

Capital Savings Plan Contract Certificates, with a load of 17.84% in the noninsurance type of plan and 18.39% in its insurance plan (25.19% including insurance premiums).³⁹

Financial Independence Founders Trustee Certificates, Series D, with a load of 18.11% in its noninsurance type and 18.62% in its insurance type (24.94% including insurance premiums).⁴⁰

Foundation Plan Endowment Certificates and United Endowment Foundation Endowment Certificates, related plans, with a load of 16.87% in the noninsurance type and 17.53% in the insurance type (25.76% including insurance premiums).⁴¹

Fundamerican Trusteed Certificates, with a load of 17.30% for the noninsurance type and 17.97% for the insurance type (26.29% including insurance premiums).⁴²

Trusteed Income Estates Certificates, Series C, with a load of 19.67% in the noninsurance type and 20.45% in the insurance type (28.82% including insurance premiums).⁴³

Independence Fund Trust Certificates, with a load of 18.38% in the noninsurance type and 19.14% in the insurance type (23.55% including insurance premiums).⁴⁴

³⁸ Under this plan certificate holders paid in the aggregate sum of \$809,775 in the period from February 27, 1937, to December 31, 1937. (Securities Registration Statement of Benjamin Franklin Foundation, Inc., File No. 2-3550, filed with the Securities and Exchange Commission December 9, 1937, Amendment filed May 27, 1938, Exhibit O-P, p. 7.) This amount includes payments on fully paid plans.

³⁹ Under this plan certificate holders paid in the aggregate sum of \$4,659,156, including payments on fully paid plans, from the inception of the plan in 1931 to December 31, 1937 (reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Table 19, and supplementary information for 1936 and 1937).

⁴⁰ Under all plans sponsored by Financial Independence Founders, Inc., certificate holders paid in the aggregate sum of \$4,730,493, including payments on fully paid plans, from the inception of the plans in 1930 to December 31, 1937 (reply to the Commission's questionnaire for Financial Independence Founders Trustee Certificates, Series D, Table 19, and supplementary information for 1936 and 1937).

⁴¹ Under these plans certificate holders paid in the aggregate sum of \$2,820,473, including payments on fully paid plans, from the inception of the plan in 1935 to December 31, 1937 (reply to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Table 19, and supplementary information for 1936 and 1937; and reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Table 19, and supplementary information for 1936 and 1937).

⁴² Under this plan certificate holders paid in an aggregate sum of \$644,960, including payments on fully paid plans, from the inception of the plan in 1933 to December 31, 1937 (reply to the Commission's questionnaire for Fundamerican Trusteed Certificates, Table 19 and supplementary information for 1936 and 1937).

⁴³ Under this plan certificate holders paid in the aggregate sum of \$1,315,000, including payments on fully paid plans, from the inception of the plan in 1935 to December 31, 1937 (reply to the Commission's questionnaire for Trusteed Income Estates Certificates, Series C, Table 19, and supplementary information for 1936 and 1937).

⁴⁴ Under this plan certificate holders paid in the aggregate sum of \$8,881,622, including payments on fully paid plans, from the inception of the plan in 1931 to December 31, 1937 (reply to the Commission's questionnaire for Independence Fund Trust Certificates, Table 19, and supplementary information for 1936 and 1937).

Independence Fund Declarations of Trust and Agreements, with a load of 16.85% in the noninsurance type and 17.53% in the insurance type (21.57% including insurance premiums).⁴⁵

Wellington Foundation Trust Certificates, with a load of 15.61% in the noninsurance type and 16.89% in the insurance type (25.08% including insurance premiums).⁴⁶

These plans accounted for over \$28,000,000 in payments made by certificate holders out of a total of payments in the industry of approximately \$55,000,000 from the inception of the plans to the end of 1937.

The amounts and percentages of the total loading charges discussed above are theoretical and represent the load after the completion of the plan by the certificate holder. Since the sponsor deducted the service fee in the beginning of the plan and not evenly over the 10-year period, for the actual load to equal the theoretical load the investor would have to continue his payments regularly for 10 years.⁴⁷ At any time prior to the expiration of that period of time, the load was actually higher than the theoretical load—in the early years of the plan many times greater.

Moreover, the amounts of fees set forth in these tables do not include incidental costs borne by the investor; nor do they take into account the hidden loads or double loads which are discussed more fully in a subsequent section. Adjustments to higher fractions, trading profits, positions taken by sponsors, exchange fees, and other miscellaneous tribute increased the load borne by the investor. This load at times amounted to from 2% to 3% of the amount invested for the certificate holder.⁴⁸ Items such as brokerage, taxes, and expenses pertaining to and borne by the certificate holder's fund, also increased the cost to the certificate holder.

For purposes of comparison with other securities in the investment-trust field it may be noted that securities of closed-end management investment companies bore an underwriting and distribution load averaging 5.8% of the net proceeds to the companies⁴⁹ during the period 1927 to 1935. The securities of open-end management in-

⁴⁵ Under this plan certificate holders paid in the aggregate sum of \$2,263,252 from the inception of the plan in 1935 to December 31, 1937 (reply to the Commission's questionnaire for Independence Fund Declarations of Trust and Agreements, Table 19, and supplementary information for 1936 and 1937).

⁴⁶ Under this plan, certificate holders paid in the aggregate sum of \$2,232,525, including payments on fully paid plans from the inception of the plan in 1935 to December 31, 1937 (reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Table 19, and supplementary information for 1936 and 1937).

⁴⁷ It may be noted that some sponsors, in an effort to minimize their sales load, have increased the term of their plans to 15 years with a corresponding increase in the amount payable, but no increase in the sales load. While the load as a percentage is thereby reduced, it is not less in actual amount. Furthermore, in order to attain the benefits of the decreased percentage, the investor must continue his payments five years longer.

⁴⁸ Hearings *In the Matter of Financial Independence Founders, Inc.*, held on June 6, 1938, pursuant to order for investigation dated April 19, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 261.

See also Securities Registration Statement of Benjamin Franklin Foundation, Inc., File No. 2-3550, filed with the Securities and Exchange Commission December 9, 1937 (prospectus filed July 9, 1938), indicating that the 9.2% published secondary sales load actually amounted to 12.4% of the net amount invested during the year 1937.

⁴⁹ See the Commission's over-all report on investment trusts and investment companies, Pt. Two (House Doc. No. 70, 76th Cong.), Ch. II, B. 1 (c), and Table 67.

vestment companies and fixed investment trusts bore a greater load but in general ranged from 5% to no more than 10% of net asset value, and, in some cases, was as low as 1% and 2%.⁵⁰

Compared with these fees, the installment plan certificate, sold to small investors on a periodic payment basis mainly because they could not afford to invest large sums and sold as a supposed "economic necessity," bore the heaviest load of all—an average of 15.56%, and in plans where insurance was provided, 16.58%, not including insurance premiums. As indicated, many of the widest sold plans bore loads which were substantially higher than the average—ranging from approximately 17% to 20%.

Furthermore, the fees discussed above comprise only those fees levied upon the payments of principal made by the investor. Other deductions in most plans were made from distributions, particularly by reason of the secondary sales load upon the purchase of the underlying security with reinvested distributions. Deductions, termed supervisory or maintenance fees, were also levied on the distributions received on the funds of certificate holders in many instances. Table 7 reveals the types and amounts of these fees deducted from distributions.

In many cases where the load on principal payments was relatively small, deductions from distributions were substantial. Thus, Corporate Leaders Trust Certificates, where the load on principal was only \$85, or 7.55% of the net amount invested, provided for deductions from income equal to 1/12 of 1% per month on the market value of the fund itself. In the period from 1931 to 1935, this deduction from dividends, termed an administration fee, amounted to over 24% of dividends received.⁵¹ In the case of Corporate Leaders Trust Certificates, Series A, a subsequent plan offered by the same sponsor after 1936, and which, incidentally, had a greater load than the first plan, 14.07%, this deduction of 1/12 of 1% amounted to more than 25% of distributions for the year 1937.⁵² Moreover, this charge was a fixed percentage of the investor's principal funds and was therefore not dependent upon the possibilities or probabilities of earnings.

Euclid Investment Trust Certificates, where the load on principal was approximately 10%, deducted 25% of all earnings.

Trust Endowment Agreements, where the principal load was \$120, or approximately 11% of the net amount invested, provided for three different deductions from income: (a) secondary sales load upon the reinvestment of distributions, (b) a trustee's fee of 25 cents per month, and (c) a semiannual fee of 1/30 of 1% of the market value deducted for the trustee of the underlying fixed trust.

Thrift Investment Certificates of Agreement had a principal load of only 9.47%. In this plan, however, not only did the certificate holder pay a 5% commission on all distributions that were reinvested, but there was deducted from distributions annually an amount equal to 2% of the amount theretofore invested for the certificate holder.

⁵⁰ Id., Sec. III, B, 3, and Table 63.

⁵¹ Reply to the Commission's questionnaire for Corporate Leaders Trust Certificates, Item 30, Table 19, and Item 11, Table 8.

⁵² Securities Registration Statement of Corporate Leaders of America, Inc., File No. 2-1777, filed with the Securities and Exchange Commission November 25, 1935 (prospectus filed May 14, 1938, Supplemental Data, p. 1). It may be noted that in addition a "Distribution Fee" of 30 cents was deducted in this plan from each distribution which occurred semi-annually.

TABLE 7.—*Deductions from distributions made under 47 installment investment plans*

Name of plan	Sales load on reinvested distributions (percentage of amount invested)	Supervisory, management or maintenance fees (percentage based on income)	Supervisory, management or maintenance fees (percentage based on fund)
American Participations, Inc.	No fees on distributions.		
Benjamin Franklin Foundation Trust Certificates.	9½%-----		Depositor for T. I. S. deducts quarterly ⅓ of 1% of average daily market value of fund.
Capital Savings Plan Contract Certificates.	9%-----	Depositor of underlying shares deducts 2½% semiannually.	
Trust Endowment Agreements.	9%-----	Trustee's fee of 25¢ per month per certificate.	Semiannual fee of ⅓ of 1% of market value by trustee of underlying shares.
Trust Endowment Agreements, Type B.	9%-----		Semiannual fee of ⅓ of 1% of market value by trustee of underlying shares.
Corporate Leaders Trust Certificates.			Sponsor of fund deducts ½ of 1% per month of average market value.
Corporate Leaders Trust Fund Certificates, Series A.			Trustee of fund deducts ½ of 1% per month of market value.
Euclid Investors Trust Certificates.		25% of all net earnings.	
Financial Independence Founders, Inc. Certificates, Series D.	9¼%-----		
Financial Security Fund Plan.	⅓ of 1% quarterly of total amount payable.		Investment counsel receives quarterly fee of ⅓ of 1% of net assets.
Foundation Plan, Inc., Endowment Certificates.	8.1%-----		
Fundamerican Trusteed Certificates.	8½%-----		
General Reserves Corporation Trust Fund Certificates.	No fees on distributions.		
Hamilton Trust Share Certificates.			Sponsor of plan deducts ⅓ of 1% quarterly of market value.
Trusteed Income Estates Certificates, Original Series.	9½%, but there is a discount of 6% of the offering price.		Depositor for T. I. S. deducts quarterly ⅓ of 1% of average daily market value of fund.
Trusteed Income Estates Certificates, Series C.	4½%-----		Same as Original Series.
Income Foundation Fund Agreements and Certificates of Trust.		9% of each dividend received.	
Income Foundation Contracts D and E.	8¾%-----		Management fee of Bullock Fund is ⅓ of 1% quarterly of market value.
Income Foundation Contracts F and G.	9½%-----		Same as D and E.
Independence Fund Participation Agreements.	Approximately 4%--	20% on excess over 6% in distributions semiannually.	

TABLE 7.—*Deductions from distributions made under 47 installment investment plans—Continued*

Name of plan	Sales load on reinvested distributions (percentage of amount invested)	Supervisory, management or maintenance fees (percentage based on income)	Supervisory, management or maintenance fees (percentage based on fund)
Independence Fund Trust Certificates.	9½%-----	-----	
Independence Fund Declarations of Trust.	No fees on distributions.	-----	
Individual Assured Estates Inc., Endowment Trust Certificates.	8.1%-----	2½% of all income received and reinvested.	
Insured Investors, Series A Certificates.	9.89%-----	-----	
Insured Investors, Series B Certificates.	8%-----	-----	
International Investment Trust Units.	-----	-----	Trustee may deduct monthly ½ of 1% of the then deposited securities and cash.
Investors Independence Trust Share Certificates.	9%-----	3% of income. Depositor of underlying shares deducts 2½% semiannually.	Depositor for T. I. S. deducts quarterly ¼ of 1% of average daily market value of fund.
Future Requirements Plan Investment Certificates, FA and FB.	9%-----	Depositor of underlying shares deducts 2½% semiannually.	
Future Requirements Plan Investment Certificates, FC and FD.	9½%, but there is a discount of 6% of the current market price.	-----	
Lexington Foundation Contract Certificates, L, LN, LP.	9½%-----	-----	
Liberty Thrift Foundation Trust Certificates.	9½%-----	-----	
Assured Independence Plan Trust Certificates.	7½%-----	-----	Depositor for T. I. S. deducts quarterly ¼ of 1% of average daily market value of fund.
National Trustee Fund Certificates.	Estimated 6.2%-----	Depositor of underlying shares deducts 2½% semiannually.	½ of 1% paid to trustee at termination of fund.
National Trustee Fund Certificates, Contract Certificates.	6%-----	Depositor of underlying shares deducts 2½% semiannually.	
National Unit Cumulative Investment Certificates.	No fees on distributions.	-----	
North American Bond & Share Certificates.	8%-----	Compensation to sponsors of M. I. T. is 6% of annual gross earnings.	
Commonwealth Fund Trust Certificates.	7%-----	-----	
Accumulating Investment Plan Subscription Certificates.	10%-----	Managers of underlying security receive 20% of all distributions in excess of 1½% quarterly.	Managers of underlying security receive ¼ of 1% quarterly of asset value of fund.

TABLE 7.—*Deductions from distributions made under 47 installment investment plans—Continued*

Name of plan	Sales load on reinvested distributions (percentage of amount invested)	Supervisory, management or maintenance fees (percentage based on income)	Supervisory, management or maintenance fees (percentage based on fund)
Prudential Assured Estates Trust Certificates.	9½%-----	-----	2% annually of the amount theretofore invested. ⅓ of 1% of value of underlying property of Deposited Insurance Shares, Series A, semiannually. ⅓ of 1% of value of underlying property of Deposited Bank Shares, N. Y.—Series A, semiannually.
Standard Trust Foundation Agreement.	9%-----	-----	
Thrift Investment Certificates of Agreement.	5%-----	-----	
Insurance Stock Plan Contract Certificates.	8.7%-----	-----	
N. Y. Bank Stock Plan Contract Certificates.	8.7%-----	-----	
Union Investment Trust Series A-K.	No fees on distributions.	-----	
United Endowment Foundation, Inc., Endowment Certificates.	8.1%-----	-----	
United Fund Certificates, T. A.	No fees on distributions.	-----	
Wellington Foundation Trust Certificates.	-----	Sponsor receives 5% of distributions. Management fee on Wellington Fund, Inc. is from 15% to 25% on excess over 6% in earnings or unrealized appreciation.	

Earnings and appreciation of certificate holders' funds naturally depend upon the net amount invested. As a result of the heavy fees and charges deducted in the installment investment plan, the amount invested for certificate holders was small, making greater earnings and appreciation necessary in order to yield a fair return to certificate holders. Another aspect of the deduction of fees and charges affected the possibility of this return. While the proration of fees over the period of the plan is a distinct problem discussed in the following section of this report, it is necessarily tied up with the consideration of possible earnings and appreciation, since these factors of accumulation also depend upon the period of time during which funds are invested. As indicated in the following section of this report, the bulk of the sponsor's service fee was exacted during the first year of the plan. This fact rendered a fair return to certificate holders even more difficult of achievement.

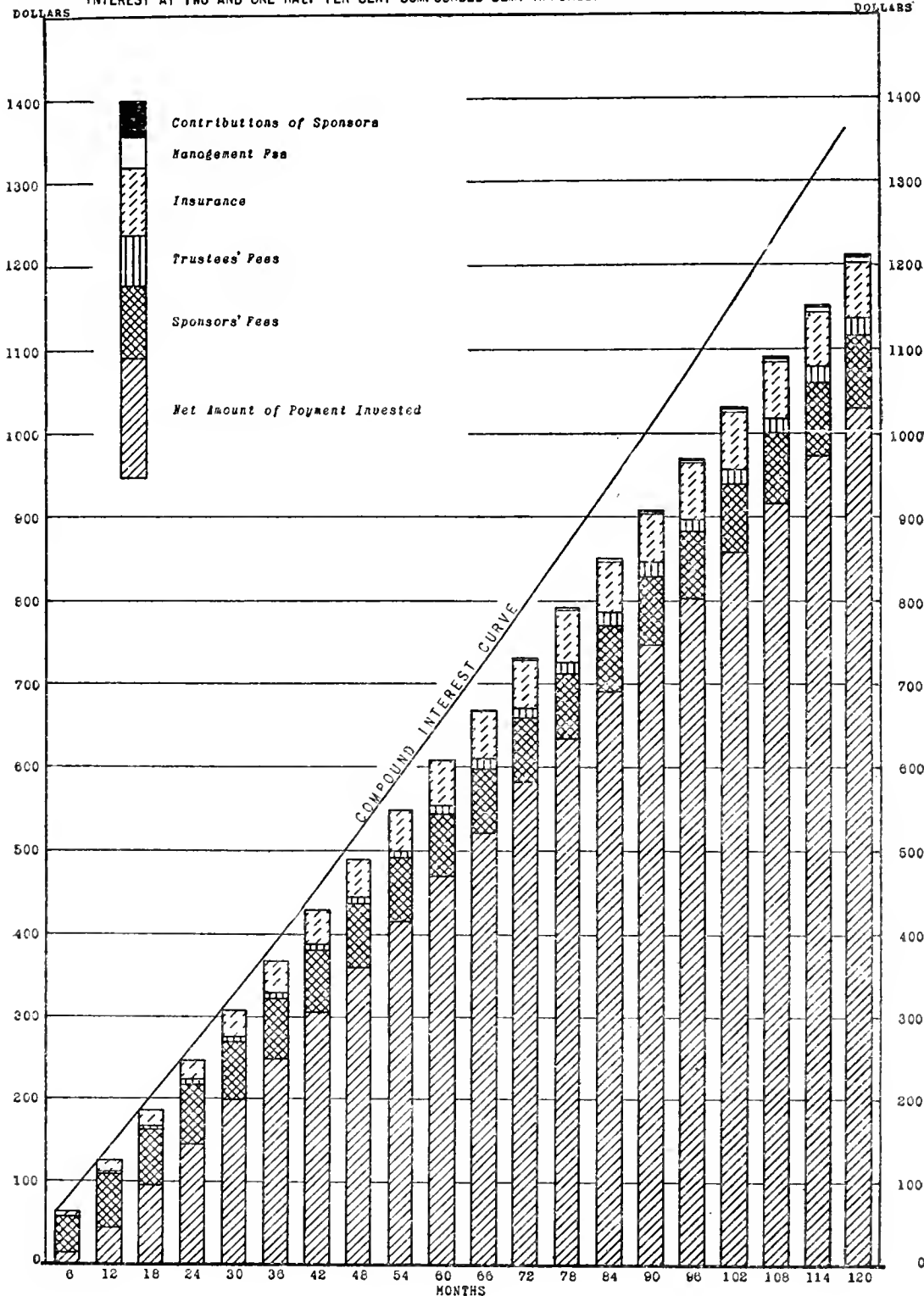
Chart 3, based on the composite fees and charges of 19 plans which had a structure sufficiently comparable to permit tabulation;⁵³ illus-

⁵³ The names of the 19 plans are: Trusteed Income Estates Certificates; United Endowment Foundation Endowment Certificates; Independence Fund Declarations of Trust and Agreement; Fundamerican Trusteed Certificates; Insured Investors Series A Certificates; Corporate Leaders Trust Certificates; Future Requirements Plan Investment Certifi-

trates this difficulty. This chart portrays the allocation of the investor's payments to sponsors' fees, trustees' fees, insurance premiums, management fees, and the actual amounts invested at semi-

CHART 3

PAYMENTS, FEES, AND CHARGES ON AN AVERAGE TWELVE HUNDRED DOLLAR CERTIFICATE HAVING INSURANCE PROVISIONS COMPARED WITH AN AMOUNT OF TEN DOLLARS INVESTED MONTHLY WITH INTEREST AT TWO AND ONE HALF PER CENT COMPOUNDED SEMI ANNUALLY. AVERAGE OF NINETEEN PLANS.



cates; Wellington Foundation Trust Certificates; Trusteed Income Estates Certificates, Series C; Capital Savings Plan Contract Certificates; National Trustee Fund Contract Certificates; American Participation Certificates; Trust Endowment Agreements; Investors Independence Trust Share Certificates; Foundation Plan Endowment Certificates; Independence Fund Trust Certificates; Financial Independence Founders Trustee Certificates; Commonwealth Trust Certificates; Independence Fund Participation Agreements.

annual periods over the life of the plans, but secondary sales load has been omitted. Also indicated is the amount of sponsor's contributions or refunds for several plans.

For purposes of comparison, the chart contains a compound interest curve showing the growth of \$10 monthly deposits carrying interest compounded semi-annually at $2\frac{1}{2}\%$. The amount saved and earned under this savings program is naturally increasingly greater than the amount invested in the installment investment plan less deductions over the 10-year period. The differences between the amounts in the savings account with the $2\frac{1}{2}\%$ interest increments and the net amounts invested for these installment plan certificate holders have to be made up by appreciation or earnings on the underlying securities if the plans are to equal the performance of the savings account.

The excess of the amounts in the savings account over the amounts available for investment in the 19 installment plans is set forth for the indicated periods in Table 8. On a percentage basis the difference at various times ranges from 355.9% at the end of the first six months to 30.8% at the end of the tenth year. Thus, after six months an increase in the investor's fund from earnings or market appreciation of 355.9% would be required to equal an ordinary $2\frac{1}{2}\%$ savings program. At the end of two years, a 66.2% increase would be needed. The percentage would gradually decrease as payments were made by the certificate holder, but even after 10 years of regular monthly payments a 30.8% increase would be required. Obviously the installment investment plans would have to achieve substantial earnings or appreciation if they were to equal even ordinary savings plan results.

TABLE 8.—Comparison of net amount invested in underlying securities in installment investment plans with accumulated amount of \$10 monthly savings program with interest at $2\frac{1}{2}\%$ percent per annum compounded semiannually

Number of years payments	Total amount of payments by certificate holders ^a	Net amount invested in underlying securities ^b	Accumulated amount of \$10 monthly deposits at $2\frac{1}{2}\%$ interest compounded semiannually	Excess of amount accumulated under savings program over net amount invested in underlying securities	Percent of excess to net amount invested
$\frac{1}{2}$	\$65.57	\$13.19	\$60.13	\$46.94	355.9
1	127.17	46.71	121.01	74.30	159.1
$1\frac{1}{2}$	187.17	96.35	182.66	86.31	89.6
2	247.17	147.49	245.07	97.58	66.2
$2\frac{1}{2}$	307.17	199.87	308.26	108.39	54.2
3	367.17	253.01	372.23	119.22	47.1
$3\frac{1}{2}$	427.17	306.47	436.99	130.52	42.6
4	487.17	360.31	502.59	142.28	39.5
$4\frac{1}{2}$	547.17	414.38	569.02	154.64	37.3
5	607.17	468.92	636.24	167.32	35.7
6	727.17	579.32	773.21	193.89	33.5
7	847.17	691.96	913.66	221.70	32.0
8	967.17	805.62	1,057.66	252.04	31.3
9	1,087.17	920.88	1,205.27	284.39	30.9
10	1,207.17	1,037.55	1,356.60	319.05	30.8

^a Includes initial fees in the case of five plans.

^b Includes contributions by sponsors in the case of five plans, but omits secondary sales load.

The fees, loads, and charges that were actually deducted in the installment plan field were larger than the theoretical or stated deductions based upon completed plans.⁵⁴ During the period 1930 to 1937, certificate holders in 33 plans comprising the bulk of the industry made payments aggregating \$52,553,000 out of which the sponsors received \$8,988,000 in primary loading charges and other fees. Only \$45,540,000, consisting of certificate holders' payments and net income available for reinvestment, was used to purchase underlying securities, and out of this sum secondary loading charges were paid. The sponsor's primary sales load was 20% of the amount used to purchase underlying securities. It is estimated that the total loading charges, including trustees' fees and secondary loading charges was more than 30% of the net amount invested during this period for certificate holders.

Another consideration bearing upon the question of amount of fees and charges is the actual amount of money handled for the certificate holder during the period of time for which the service fee, trustee fee, and other charges were made. Under the usual plan providing for the payment of \$1,200 in monthly payments of \$10 for a period of 10 years, the average amount of money in the hands of the trustee over the *entire* period would be \$600. On this basis, the average net investment would be \$520. The \$160 average total load amounted to 30% of this average net investment.

While the average amount handled for the investor would appear to be an element in the question of the reasonableness of the amount of fees, it was not taken into consideration by the organizers of the installment plan.⁵⁵

Concerning the total load as compared with the average amount invested for the certificate holder over the 10-year period on a \$1,200 unit, Mr. Thomas testified: ⁵⁶

Q. What you have actually invested for him is \$1,008.

A. That is the amount invested.

Q. And that averages, for ten years, \$504 a year.

A. That is correct.

Q. And he has paid for having that amount invested, \$192 over the period of ten years?

A. But that, of course, I cannot agree is the fair basis of arriving at a charge. The charge should be made and all trust charges are made based on the value of the fund, and not based on the amount put in.

Commissioner HEALY. This charge doesn't vary as the value of the fund varies, does it?

The WITNESS. Our charge is based, for instance, 5 percent of the deposits. Now, we still administer for 5 percent of the deposits irrespective of the value of the fund.

⁵⁴ See Ch. VI. Experience of Certificate Holders, for further discussion.

⁵⁵ Mr. Simonson, president of Independence Fund of North America, Inc., denied that the average amount handled for the certificate holder bore any relation to fees and charges and testified (Public Examination, Independence Fund of North America, Inc., at 6566-7):

Q. Let us get the average amount which is invested.

A. Well, a man starts in paying \$10 a month, and he pays up to \$1,200 for the ten-year period. There is no average amount, in my opinion, that can be applied to the cost.

Q. In other words, you don't think there is an average amount.

A. I don't think you can take an average amount and apply it to the fees as you have attempted to do.

⁵⁶ Public Examination, Financial Independence Founders, Inc., at 6265-7, 6268-9, 6272.

Commissioner HEALY. The fund may go up or it may go down, however.

The WITNESS. That is right.

Commissioner HEALY. And the 5 percent is still computed on the amount invested.

The WITNESS. It is computed on the amount invested; yes.

Now, the ordinary basis of charge for administering funds—and I believe I am correct in saying this—is based upon the value of the fund, a trust charge or any supervisory charge.

Commissioner HEALY. Is this charge based on the value of the fund?

The WITNESS. No; it is based on the deposits.

But the point where I disagree with Mr. Smith is that there is a set charge made for administering the fund. I am assuming the trust charge and our service charge is a charge made for administering the fund.

Now, it is my contention that that charge should be written off against the value of the fund and not against the amount put in it in arriving at the fairness of the charge.

By Mr. SMITH:

Q. Now, Mr. Thomas, in the first place you don't make your charges on that basis, do you?

You make your charges on the amount actually paid in, and whether the fund goes up or down your charges do not vary.

A. That is perfectly correct.

* * * * *

Q. What he is really paying you for is the investment, putting into these funds on an average over the whole period of \$504. Isn't that right?

A. Yes.

Q. Now, on that basis the cost to the investor is about 38.10 percent for that average fund?

A. On that basis it is, but I consider the basis very inaccurate.

Q. And you consider it inaccurate for the reason that you should take the worth of the underlying securities? Isn't that right?

A. Why does he pay us this fee, Mr. Smith? He pays us this fee with the idea that we are going to make a profit over and above his deposits, or he wouldn't pay it.

Q. That is right.

A. And if we make a profit, the charge we make should be written off against the profit and not against the deposit.

Q. Suppose we see if you agree with this. Suppose we assume you do not make any profit over the period and that the underlying securities remain just where they were when you started, and they stay at a stable amount over the whole period, so that you don't make any profit.

Now, in that case, would you agree with me that he has paid 38.10 percent?

A. On that basis I would agree with you. But why assume something which has never happened—And I cannot conceive of any condition where it would happen.

* * * * *

Q. But coming back to this point, I want to get it clear. If the Diversified D Trust Shares remained stable, or else your account worked out so that at the end of the period you had just the amount of money that had been invested—and let us disregard dividends for the moment.

A. Let us disregard dividends and market appreciation.

Q. Disregarding dividends and market appreciation, it would be 38.10 percent.

A. That is right.

The reason for the substantial fees and charges that obtained in the installment investment plan field may perhaps be found in the duplication of trustee's expenses, selling costs, maintenance, and bookkeeping expenses, and even management fees. The high cost of the plan, however, was not a necessary or inevitable result of this duplication.⁵⁷ Plans have operated with fees and charges which were much less than the average, and other plans have reduced the amount of fees and charges substantially despite the duplication of trustee's fees and sponsor's fees and attendant expenses. On the other hand, in plans where such duplication did not exist, that is, plans utilizing an underlying portfolio of common stock, or a related underlying investment medium, the amount of fees and charges were high, although less than the average.

Selling commissions undoubtedly accounted for a large part of the installment-plan burden.⁵⁸

When examined on the question of the service rendered in consideration for the service fee charged by the sponsor company, Frank D. Hughes, president of Benjamin Franklin Foundation, Inc., testified: ⁵⁹

Q. So far as the \$72 is concerned, you have already made such deductions at the end of 10 months, have you not?

A. That is correct.

Q. Are these charges service charges of your work for the first 10 months only, or for your work spread over a 10-year period?

A. They are primarily charged for the creation of a certificate or cost involved in selling the certificate. We agree, however, not to make any further charge for 10 years.

Q. In other words, it is your contention that the \$72 represents services rendered by the end of 10 months?

A. Positively; 10 minutes it should be. In other words, all the work has been done when the certificate has been sold, but we couldn't get our \$72 in most cases unless we spread it over a 10-month period.

Q. You contend that your service is worth \$72?

A. That is right.

Q. And that the \$72 is not intended to cover your cost of operation and services performed by you in looking over the certificate for 10 years?

A. That is my personal contention.

* * * * *

Q. What is the basis of the company's charge of \$72?

A. The charge of \$72 shall be deducted from the first ten deposits, and after that there is a continued commission in the purchase of the shares.

Q. What consideration do you render for the \$72?

A. The actual sale of the certificate.

Concerning this matter, Mr. Thomas testified: ⁶⁰

Q. So that isn't the difference between this 6 percent, or 7 percent, that you pay for a management trust, or for an ordinary trustee, and the 19 percent

⁵⁷ One installment plan sponsor frankly recognized that the loading cost of the installment plan "was higher than it ought to be" (Public Examination, Income Foundation, Inc., at 11666).

⁵⁸ Public Examination, Income Foundation, Inc., at 11572-3, 11575-6.

⁵⁹ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 132-4.

⁶⁰ Public Examination, Financial Independence Founders, Inc., at 6288.

which they pay you, that is made up primarily in the expense of the bookkeeping of these periodic payments, plus the salesmanship, and plus the pressure to keep the man paying; and those are the primary things, aren't they?

A. Those are the primary things; and I would like to have an opportunity to say, however, that a man who creates a trust of \$100,000 already has accumulated his money, and he has got it; and all the trust company is doing then is investing it for him.

Now, I feel that one of the great contributions that is made in these plans is the fact that you do go out and get people to set aside money which they wouldn't otherwise do; and that is a service that the trust company doesn't perform; and it costs us a lot of money to do that.

The bases for the determination of the amount of fees, thus, would seem to have been the desires or necessities of the sponsor and its selling organization rather than the investor's interest. Alfred H. Geary, president of Capital Savings Plan, Inc., testified:⁶¹

Q. Did you talk to any experts with particular respect to the various fees and charges to be made by Capital Savings Plan, Inc.?

A. I had an actuary work on the fees and charges and commission schedules.

* * * * *

Q. My question was this: You mean you actually employed some technician and some actuary to figure out the fees you are going to charge for this firm?

A. No.

Q. I ask you a much broader question—whether you discussed with any expert the advisability of this type of business and the various fees and charges which must be used or considered as compared with other forms of investment?

A. No; I don't believe I did.

The evidence seems clear that the amount of fees and charges of the installment investment plan was fixed entirely without consideration for the professed aim of the promoters of this type of security to fill an "economic need" for the small investor. Instead, this type of investor paid a load for the privilege of investing money in small periodic amounts far greater than the investor who could afford to invest lump-sum amounts directly.

3. Proration of Service Fees—Withdrawals, Defaults, and Cancelations

While the cost of the installment investment plan to the investor presented a severe handicap for his investment, his situation was seriously aggravated by the deduction of the bulk of the sponsor's primary sales load or "service fee" in the early months of the installment plan. First, the investor's money was not invested and did not begin to earn dividends substantially, in most cases, for a period of one year, and, secondly, an investor withdrawing in the first few years of the plan suffered almost inevitably a substantial loss of the money he had paid.

Table 9 indicates the proration of primary sales loads or "service fees" in 45 installment plans. This table graphically reveals that, in most plans, the sponsor's service fee was deducted from the investor's payments in the first year of the plan.⁶² While 10 plans provided for

⁶¹ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on May 24, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 61-2.

⁶² The secondary sales load and the trustee's fee, constituting the other major portions of the total loading charge, were generally evenly prorated.

a proration of such fees over the entire period of the plan, in practically every such case the major portion of the fee was collected during the first year.

Chart 3 in the preceding section illustrates one phase of the uneven proration of fees. In the early years of the plans, the relative amounts of earnings or appreciation on the underlying securities required in order to overcome the disadvantage of loads and charges, as well as the 21½% interest accumulation in the savings program, are, from the practical viewpoint, unattainable.

Clearly, early withdrawal would be invariably accompanied by loss to the investor. The earlier the withdrawal, the greater the relative loss. The large number of lapses in the installment investment plan renders this matter a problem of major importance. Mr. Thomas conceded this much: ⁶³

Q. So that in the case of these people who withdraw in the first year, they have, as we see by the chart——

A. Those who get out the first year all take a loss.

Q. And your experience to date has been that 50 per cent of your withdrawals occur in the first year, so that out of the number of withdrawals you have a very heavy percentage who take a loss; isn't that right?

A. Yes.

Approximately 40% of the total amount payable of installment plan certificates sold in the period 1930 to 1935 was lapsed at the end of 1935. Chart 4, based on 20 installment plans, shows that most defaults and withdrawals occurred after only a few payments, at a time when the greater part of the payments of the investor was taken by the sponsor as its sales load, and he had very little of his payments invested.

Table 10 shows the lapse experience of certificate holders in 11 plans having an existence of three years or more ending December 31, 1935. The sum of \$1,349,400 was returned to certificate holders out of \$2,088,750 paid in. The average total loss, expressed as a percentage, was approximately 35%. Excluding one plan with a comparatively low loss ratio, the total loss averaged over 50%.

TABLE 9.—*Proration of primary sales load over period of installment plan*

Name of plan ^a	Total loading charge	Primary sales load ^b	Proration of primary sales load		
			Period for completion of deduction of load (in months)	Amount deducted in first year	Percentage deducted in first year
American Participations Certificates.....	\$174	\$144	120	\$60	41.7
Benjamin Franklin Foundation Trust Certificates.....	197	72	9	72	100.0
Capital Savings Plan Contract Certificates.....	182	60	9	60	100.0
Trust Endowment Agreements.....	120	15	1	15	100.0
Corporate Leaders Trust Certificates.....	85	85	10	85	100.0
Corporate Leaders Trust Fund Certificates, Series A...	148	96	6	64	66.7
Euclid Investment Trust Certificates.....	118	60	6	60	100.0

See footnote at end of table.

⁶³ Public Examination, Financial Independence Founders, Inc., at 6347-8.

TABLE 9.—*Proration of primary sales load over period of installment plan—Con.*

Name of plan	Total loading charge	Primary sales load	Proration of primary sales load		
			Period for completion of deduction of load (in months)	Amount deducted in first year	Percentage deducted in first year
Financial Independence Founders Trustee Certificates, D Series.....	\$184	\$60	7	\$60	100.0
Financial Security Fund Plan.....	117	117	17	69	59.0
Foundation Plan, Inc., Endowment Certificates.....	173	90	12	90	100.0
Fundamerican Trusteed Certificates.....	177	60	8	60	100.0
General Reserves Corporation Trust Fund Certificates, Series A.....	118	90	120	9	10.0
Hamilton Trust Shares Certificates.....	120	120	17	72	60.0
Trusteed Income Estates Certificates, Original Series..	149	72	10	72	100.0
Trusteed Income Estates Certificates, Series C.....	197	72	9	72	100.0
Income Foundation Fund Agreements and Certificates of Trust (\$1,800).....	207	162	180	78	48.0
Income Foundation Investment Contracts, Plan E.....	179	60	12	60	100.0
Income Foundation Investment Contracts, Plan G....	186	60	12	60	100.0
Independence Fund Participation Agreements.....	162	120	120	48	40.0
Independence Fund Trust Certificates.....	186	60	12	60	100.0
Independence Fund Declarations of Trust and Agreement.....	186	90	9	90	100.0
Individual Assured Estates, Inc., Endowment Trust Certificates.....	180	66	43	24	36.4
Insured Investors, Series A Certificates (\$1,000).....	113	70	120	43	61.4
Insured Investors, Series B Certificates (\$1,000).....	127	82	120	50	60.1
Investors Independence Trust Share Certificates.....	172	80	15	57	71.3
Future Requirements Plan Investment Certificates, FB.....	182	60	7	60	100.0
Future Requirements Plan Investment Certificates, FD.....	135	72	10	72	100.0
Lexington Foundation Contract Certificates, LN.....	197	72	10	72	100.0
Liberty Thrift Foundation Trust Certificates.....	197	72	9	72	100.0
Assured Independence Plan Trusteed Certificates.....	176	88	120	58	65.9
National Trustee Fund, Inc., Share Certificates.....	183	72	48	55	76.0
National Trustee Fund, Inc., Contract Certificates....	169	72	10	72	100.0
National Unit Cumulative Investment Certificates....	120	84	120	61	72.6
North American Bond and Share Participating Certificates (\$960).....	160	96	15	77	80.0
Commonwealth Fund Trust Certificates.....	163	60	30	28	46.7
Accumulating Investment Plan Subscription Certificates (\$600).....	94	27	60	13	48.1
Prudential Assured Estates Trust Certificates.....	203	78	36	60	76.9
Standard Trust Foundation Agreements.....	136	80	12	80	100.0
Thrift Investment Certificates of Agreement (\$1,560)..	135	60	1	60	100.0
Insurance Stock Plan Contract Certificates (\$1,030)....	98	36	12	36	100.0
New York Bank Stock Plan Contract Certificates (\$1,030).....	98	36	12	36	100.0
United Endowment Foundation, Inc., Endowment Certificates.....	173	90	12	90	100.0
United Fund Accumulative Certificates, Series T. A....	138	55	34	45	81.8
Wellington Foundation Trust Certificates.....	162	132	120	78	59.0

* The amount of basic units that are not \$1,200 or approximately in that amount are indicated after the name of the plan.

^b Includes initial fees or creation fees.

^c Refunds totaling \$45 are made after 4 years of payments have been made.

^d Refunds totaling \$62 are made after 1 year of payments have been made.

CHART 4

AGGREGATE AMOUNT PAYABLE OF CERTIFICATES OF 20 INSTALLMENT INVESTMENT PLANS
IN DEFAULT, WITHDRAWN, AND EXCHANGED AT THE DIFFERENT INSTALLMENT PERIODS
1930 - 1935

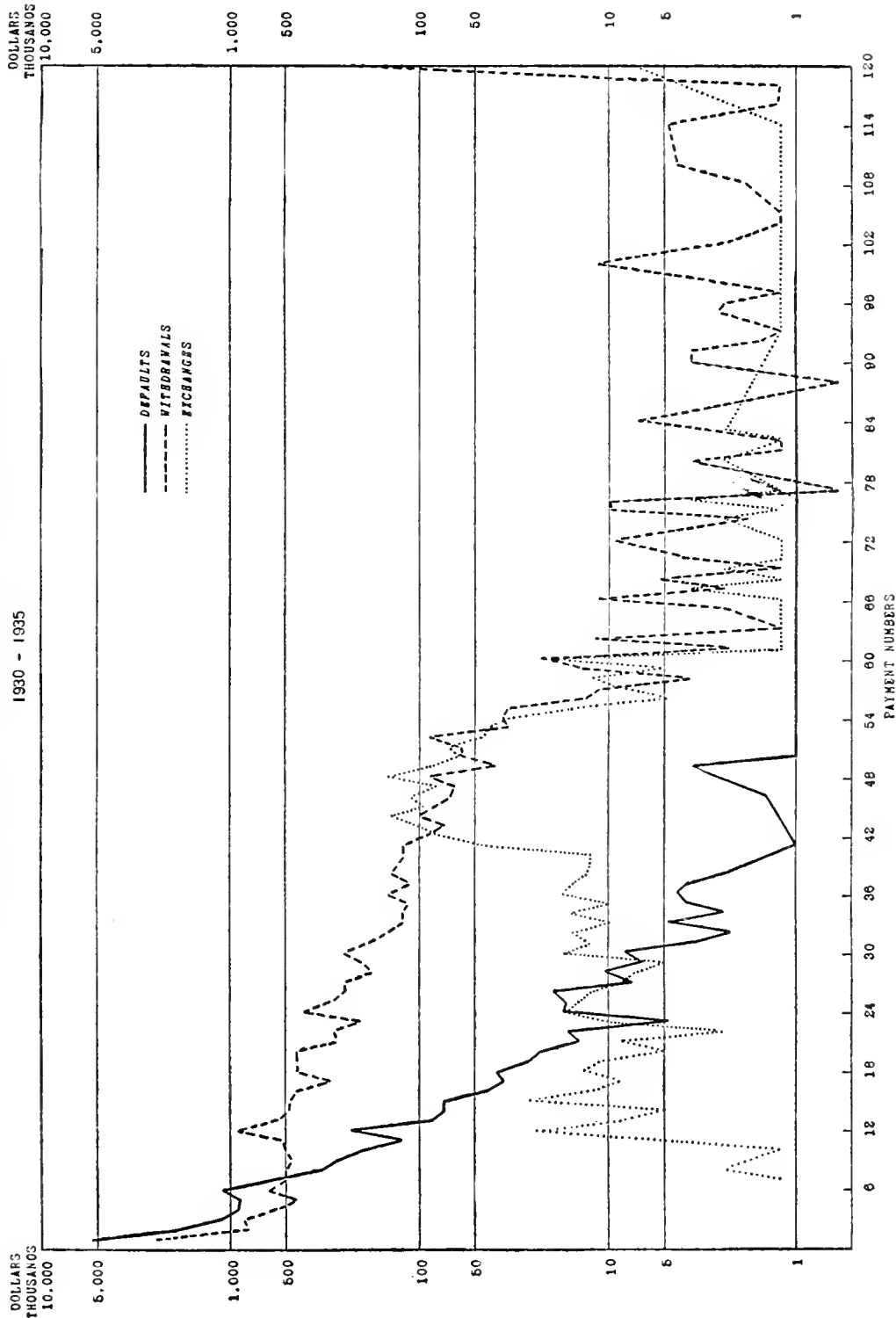


TABLE 10.—Losses to certificate holders from cancellations, defaults, and withdrawals in 11 plans with an existence of some 3 years or more ending Dec. 31, 1935 ^a

	United Endow- ment Founda- tion En- dowment Certifi- cates	3/33-12-35	Funda- ment Trusteed Certifi- cates	Insured Investors Series A Certifi- cates	Corpo- rate Leaders Trust Certifi- cates	Capital Savings Plan, Contract Certifi- cates	National Unit Cumm- lative Invest- ment Certifi- cates	Ameri- can Partici- pation Certifi- cates	Investors Independ- ence Trust Share Certifi- cates	Hamil- ton Trust Shares Certifi- cates	Independ- ence Fund Trust Certifi- cates	Financial Independ- ence Founders Trustee Certifi- cates, Series D	Total (11 plans)	Total ^b (10 plans)
Period covered.....	5/32-12/35			6/32-12/35	8/31-12/35	8/32-12/35	5/31-12/35	5/32-12/35	1/32-12/35	8/31-12/35	7/31-12/35	7/30-12/35		
<i>Cancellations</i>														
Payments by certificate holders.....	\$3,060				\$17,730		\$47,055	\$4,100	\$14,009	\$16,535		\$29,850	\$132,339	\$132,339
Payment to certificate holders.....	2,736						32,716		9,658			2,100	47,210	47,210
Loss to certificate holders:														
Amount.....	324				17,730		14,339	4,100	4,351	16,535		27,750	85,129	85,129
Percentage.....	10.6%				100.0%		30.5%	100.0%	31.1%	100.0%		93.0%	53.0%	64.3%
<i>Defaults</i>														
Payments by certificate holders.....	29,380		\$2,190	\$30,421	11,585	\$26,060	64,840	435	8,177	5,782	\$89,510		268,380	178,870
Payments or credits to certificate holders	3,297		98			7,436							10,831	10,831
Loss to certificate holders:														
Amount.....	26,083		2,092	30,421	11,585	18,624	64,840	435	8,177	5,782	89,510		257,549	168,039
Percentage.....	88.8%		95.6%	100.0%	100.0%	71.5%	100.0%	100.0%	100.0%	100.0%	100.0%		96.0%	93.9%
<i>Withdrawals</i>														
Payments by certificate holders.....	22,570		3,920	46,594	97,340	56,160	45,380	15,230		21,581	1,290,395	88,860	1,688,030	397,635
Payments to certificate holders.....	16,302		1,797	29,295	86,881	33,985	29,786	9,608		14,976	1,021,092	47,575	1,291,357	270,265
Loss to certificate holders:														
Amount.....	6,268		2,123	17,299	10,459	22,175	15,594	5,562		6,605	269,303	41,285	396,673	127,370
Percentage.....	27.8%		54.2%	37.1%	10.7%	39.5%	34.4%	36.5%		30.6%	20.9%	46.5%	23.5%	32.0%

[illegible]

• In submitted questionnaire data a consistent distinction between cancellation, default, and withdrawal was not observed. In three instances cancellations, which were shown as “none,” were probably treated as defaults; in one instance defaults, which were shown as “none,” were probably treated as cancellations, and in one instance withdrawals, which were shown as “none”, were probably treated as cancellations; according to the relationship of payments by and to certificate holders. The classified figures reflect this lack of consistent organization of data in both amounts and derived percentages, but the totals are not so affected.

The data for Independence Fund Trust Certificates are excluded.

The loss to those certificate holders withdrawing in the first year of the plan was much greater. Table 11 discloses that over 85% of their payments was lost to certificate holders who lapsed in the first year of their installment plans in the same plans considered in the previous table. Of \$528,625 paid in, only \$78,785 was returned to investors withdrawing during the first year of their plans.

Concerning the reason for securing the bulk of the service fee during the first year of the plan, David W. Barton testified:⁶⁴

Q. Why is it necessary for you, as sponsor, to take out of the first few payments a man makes, those payments which, if they were invested in the market would do him the most good over a period of years? Why don't you take those particular items as your compensation for sponsoring the plan, over a period of years?

A. The reason is this: It is similar to insurance, because the cost in distributing insurance is largest—the biggest cost in distributing it is the selling cost or acquisition cost. That cost occurs at the time the sale is made. The salesman must of necessity, and he has to live. He can't wait and take his commission on a small unit of sale over a ten-year period. It must of necessity be taken out on small units during the early period of the contract. The insurance companies have been facing that same problem for generations, and they have never found a solution to it.

As we all know, out of the first year's insurance premium, 60% goes to the sales organization. Thereafter, I think for 9 years, something like 9% goes. If they can't spread their acquisition cost, how can we be expected to do so. We have done so on large units, which will be brought out at the next hearing.

Q. Why shouldn't that be the duty of a sponsor company, to see that the salesmen are paid and to not get its payment until such time, as—to spread its payment over the life of the contract.

A. Do I understand you to mean that you would expect the sponsor company to advance the commissions?

Q. Why isn't that the duty of the sponsor company?

A. It would take a tremendous amount of money, and it would add tremendously to selling cost, because that money advanced by the sponsor company would have to receive some return. We frankly have worked out such a plan on larger units, which I will go into when we get into our present plan.

This "present plan" mentioned by Mr. Barton and several other plans provided for equal proration of the sales load over the entire period of the plan. In these plans, however, a withdrawal or termination fee was assessed which resulted in the same or even heavier loss to the certificate holder upon early withdrawal or lapse. While one problem—that of early investment of payments—was solved by these types of plan, another problem—that of loss on early withdrawal—remained and was even intensified.

⁶⁴ Public Examination, Income Foundation, Inc., at 11658.

TABLE 11.—Losses to certificate holders in 11 plans from cancellations, defaults, and withdrawals during the first year •

	United Endow- ment Founda- tion En- dowment Certifi- cate	Fund- amer- ican Trust- ed Certifi- cate	Insured Investors Series A Certifi- cate	Corpo- rate Leads Trust Certifi- cate	Capital Savings Plan, Contract Certifi- cate	National Unit Cumulative Invest- ment Certifi- cate	Ameri- can Parti- cipation Certifi- cate	Investors Independ- ence Share Certifi- cate	Hamil- ton Trust Shares Certifi- cate	Independ- ence Fund Trust Certifi- cate	Financial Independ- ence Founders Trustee Certifi- cate Series D	(Total) (11 plans)
Cancellations												
Payments by certificate holders.....	\$2,930			\$17,730		\$9,390	\$4,100	\$2,873	\$16,175		\$21,240	\$74,438
Payments to certificate holders.....	2,636					3,629		1,292			563	8,120
Loss to certificate holders:												
Amount.....	294			17,730		5,761	4,100	1,581	16,175		20,677	66,318
Percentage.....	10.0%			100.0%		61.4%	100.0%	55.0%	100.0%		97.3%	89.1%
Defaults												
Payments by certificate holders.....	24,900	\$2,190	16,013	11,585	\$19,780	41,585	435	7,603	4,380	\$89,510		217,981
Payments or credits to certificate holders.....	1,026	98										1,124
Loss to certificate holders:												
Amount.....	23,874	2,092	16,013	11,585	19,780	41,585	435	7,603	4,380	89,510		216,857
Percentage.....	95.9%	95.5%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%		99.5%
Withdrawals												
Payments by certificate holders.....	1,880	1,920	8,642	11,805	15,740	3,400	4,775		4,057	165,095	18,890	236,204
Payments to certificate holders.....	6389	658	2,593	6,079	3,296	1,266	1,977		1,433	47,582	4,269	69,542
Loss to certificate holders:												
Amount.....	1,491	1,262	6,049	5,726	12,444	2,134	2,798		2,624	117,513	14,621	166,662
Percentage.....	79.3%	65.7%	70.0%	48.5%	79.1%	62.8%	58.6%		64.7%	71.2%	77.4%	70.6%
Total												
Payments by certificate holders.....	29,710	4,110	24,655	41,120	35,520	54,375	9,310	10,476	24,612	254,605	40,130	528,623
Payments to certificate holders.....	4,051	756	2,593	6,079	3,296	4,895	1,977	1,292	1,433	47,582	4,832	78,786
Loss to certificate holders:												
Amount.....	25,659	3,354	22,062	35,041	32,224	49,480	7,333	9,184	23,179	207,023	35,298	449,837
Percentage.....	86.4%	81.6%	89.5%	85.2%	90.7%	91.0%	78.8%	87.7%	94.2%	81.3%	88.0%	85.1%

• In submitted questionnaire data a consistent distinction between cancellation, default, and withdrawal was not observed. The classified figures reflect the lack of consistent organization of data but the totals are not so affected.

• Estimated on basis of the other 10 plans (30% of payments by certificate holders).

Income Foundation Fund Agreements and Certificates of Trust offered two options to investors in connection with the sponsor's fees.⁶⁵ Under one option, fees amounting to 9% of the face amount of the certificate were deducted at the rate of 4% the first year (12 equal monthly deductions) and 5% from each payment over the life of the plan, that is, \$48 was deducted in the first year and \$60 in the succeeding nine years. Under the second option, the sponsor's fee was deducted at the rate of 9% on each payment made over the life of the certificate. In the event of withdrawal by the investor from the first type of plan, the trust agreement provided that "Distributor's compensation * * * (4% of the face amount of the certificate) and * * * the 5% of each payment actually made, if not previously deducted, will be deducted from liquidating value and paid to the Distributor." Under the second type, in the event of termination "a penalty is assessed equal to 5% of the difference between the face amount of the certificate and the amount actually paid in, which penalty is payable to the Distributor in lieu of the compensation it would have received if the payments had been completed as agreed."

Mr. Barton's testimony concerning the reasons for offering plans with the optional charges is also illuminating on the subject of the reason for the sponsor's large fees and the investors understanding of them:⁶⁶

Q. You are selling two different types of plans at the present time, are you not?

A. Forgetting the insurance feature for the moment, our trust plans are identical in every respect, with the exception of the reductions or compensations to distributors. The distributor's fee is limited to a maximum of 9 percent of the total amount of payments to be made on the trust. They are also entitled to a maximum of 9 percent of reinvested dividends.

* * * * *

Many larger trust holders raise this objection: they say, "We do not object to the 9 percent service fee over a 15-year period. That is perfectly fair. It is less than 1 percent per year. But we do object to having a large part of it taken out during the first year."

We say, "All right; we are entirely satisfied to pro rate that fee over the entire life of the trust, but remember, it is primarily designed to cover selling expenses, and that expense has been met at the time the sale was made. If we pro rate it by taking 10 percent or 9 percent out of each payment as made, and you make two or three payments and stop, you have failed to perform your part and we have lost money. Our organization cannot live on that basis; therefore, if you fail to go through with your payments according to the contract, we, the distributing organization, are entitled to a maximum of 5 percent of the difference between what you have paid in and what you contracted to pay in."

That makes the cancellation fee gradually reducing, which disappears completely with the final payment.

⁶⁵ Sponsor's fees herein described in connection with Income Foundation Fund Agreements and Certificates of Trust are exclusive of an additional fee of 9% on earnings on the underlying securities also paid to the sponsor. This, however, was the only charge paid to the sponsor; there was no secondary sales load.

⁶⁶ Public Examination, Income Foundation, Inc., at 11693.

I stated in the beginning that the other plan of deduction was designed primarily for the small investor, and as a practical matter it is generally one that is being sold to the small investor.

The reason we recommend it is because the small investor—it can be explained to him that the cost takes place in the beginning. If you stop at the end of the first year or the middle of the first year you will have very little, if any, value. Beyond that point you can go on and pay, and there is no cancellation fee.

Now, if we offer him, which we do—if we stress the other plan of deduction, we have found by experience that the small investor does not understand that cancellation fee. He will come in maybe after he has made two or three payments and ask the Trustee, “What have I got standing to the credit of my trust?” “You have got X number of shares. It shows there is a nice profit, but if you cancel now, remember you have not made the payments you have agreed to make, and the distributor gets a cancellation fee.”

He has forgotten that, if he ever understood it, and we have found that it makes for very much less misrepresentation or misunderstanding by having the unsophisticated investor adopt the plan deduction rather than what I term the “C” plan of deduction.

The deductions from payments and the application of withdrawal fees on Income Foundation Fund Agreements and Certificates of Trust were summarized in the following schedule submitted in connection with the public hearing on this plan.⁶⁷

SCHEDULE OF CHARGES ON INCOME FOUNDATION FUND AGREEMENTS

The withdrawal value of the Plan “A” and Plan “B” certificates is much higher than the corresponding value of the Plan “C” and Plan “D” certificates. For example, at the end of the first year the accounts under Plan “A” and under Plan “C” are in the following condition (unit of \$10 per month for 180 months) :

	Year	Paid in	Trustee's fees	Sponsor fees	Invested in underlying securities
Plan A.....	1	\$120	\$3. 00	\$78. 00	\$39. 00
Do.....	2	240	6. 00	84. 00	150. 00
Plan C.....	1	120	3. 00	10. 80	106. 20
Do.....	2	240	6. 00	21. 60	213. 00

But presuming a steady market value and no dividend payments, the withdrawal value would be :

	Year	Amount invested	Withdrawal charge	Amount received
Plan A.....	1	\$39. 00	(a)	\$39. 00
Do.....	2	150. 00	(a)	150. 00
Plan C.....	1	106. 20	\$84. 00	22. 20
Do.....	2	213. 60	78. 00	135. 60

• All paid.

⁶⁷ Id., Commission’s Exhibit No. 1156. Plan “B” and Plan “D” are the plans with insurance provisions, corresponding respectively to Plan “A” and Plan “C”.

This schedule shows the difference in withdrawal fees between the two plans described above and indicates that subscribers to Plan C had 88.3% of their payments actually invested at the end of the first year in comparison to 32.5% invested under Plan A. However, in the event of withdrawal, subscribers to Plan C received less than subscribers to Plan A.⁶⁸

Recently, Income Foundation Fund, Inc., has sponsored an installment investment plan that entirely eliminates unequal proration of the sponsor's sales load.⁶⁹ The sponsor's load in this plan amounts to 9% of each periodic payment. No termination fees or withdrawal fees are charged. As a consequence, the sponsor's load in this plan is spread evenly over the entire period of the investor's program and no loss with respect to fees, greater than the 9% load, is sustained by a withdrawing certificate holder. The minimum periodic payment required under this plan is \$25.

Thus it would appear that the exaction of the sponsor's fee in the first few months of the plan, as is the case generally among other installment plans, is not an unavoidable practice.

Aside from those withdrawal fees which were deducted in accordance with a schedule in those plans that prorated the "service fee" over the entire period of the plan, withdrawal or default fees were exacted upon withdrawal prior to the completion of payments under the plan or upon default in payment for a certain period of time. Such withdrawal or default charges were in the nature of penalties, levied apparently in an effort to retard the number of defaults or withdrawals. These penalties increased the loss to investors upon withdrawal. Mr. Thomas conceded that such fees were undesirable.⁷⁰

In view of the fact that withdrawal was accompanied by additional deductions or termination fees, the mere disclosure of service

⁶⁸ In the case of Trust Endowment Agreements, sponsored by Corporate Equities, Inc., which derived its major fee evenly over the period of the plan through a secondary sales load, the schedule of withdrawal fees as set forth in its prospectus (in percentages only, dollar amounts having been calculated) for the selected periods shown is as follows (reply to the Commission's questionnaire for Trust Endowment Agreements, Exhibit K) :

Amount of payments received	Termination fee (percentage of amount payable)	Dollar amount of \$1,200 unit
\$10.....	$\frac{5}{12}$ ths of 1%.....	\$5
\$20.....	$\frac{5}{6}$ ths of 1%.....	10
\$30.....	1 $\frac{1}{4}$ %.....	15
\$40.....	1 $\frac{3}{4}$ %.....	20
\$50.....	2 $\frac{1}{12}$ %.....	25
\$60.....	2 $\frac{1}{2}$ %.....	30
\$70 to \$120.....	2 $\frac{1}{12}$ %.....	35
\$550 to \$600.....	2 $\frac{1}{4}$ %.....	27
\$850 to \$900.....	1 $\frac{5}{12}$ %.....	17
\$1,150 to \$1,200.....	(*).....	-----

* After the 115th payment, the withdrawal fee decreases $\frac{1}{18}$ of 1% upon receipt of each further payment to 65¢ at the 119th payment.

⁶⁹ Securities Registration Statement of Income Foundation Fund, Inc., File No. 2-3933 filed with the Securities and Exchange Commission February 9, 1939, Item 28.

⁷⁰ Public Examination, Financial Independence Founders, Inc., at 6342.

fees, trustee fees, and other loads does not indicate the full extent of the deductions to which a certificate holder's account was subject upon withdrawal. Table 12, covering 10 plans selected as representative of the various types of installment investment plan studied, indicates the loss to investors upon withdrawal at various periods of time in the 10-year span of the installment plan.

After the first six months of most plans, a withdrawing certificate holder sustained practically a total loss. At the end of a year this loss was well over 50% in many plans. The loss gradually diminished with the continued receipt of payments over the life of the plan, until it finally equaled the actual total loading charge on the entire plan.

The likelihood of withdrawal prior to the completion of the plan and the consequent probability of heavy loss creates for numerous investors an acute situation that deserves consideration as much as the burden of the total load borne by investors.

TABLE 12.—Schedule showing amounts available for withdrawal and losses at various periods of time for 10 representative instalment investment plans ^a

Name of Plan	6 months				1 year				2 years				5 years				Remarks
	Amount paid in	Amount available for withdrawal	Amount of loss	Percent of loss to amount paid in	Amount paid in	Amount available for withdrawal	Amount of loss	Percent of loss to amount paid in	Amount paid in	Amount available for withdrawal	Amount of loss	Percent of loss to amount paid in	Amount paid in	Amount available for withdrawal	Amount of loss	Percent of loss to amount paid in	
Capital Savings Plan Contract Certificates.	\$60	\$17.61	\$42.39	70.65	\$120	\$22.29	\$97.71	56.43	\$240	\$159.63	\$80.37	33.49	\$600	\$481.10	\$118.90	19.82	Includes service fee, trustee fee and secondary sales load.
Trust Endowment Agreements.	75	24.75	50.25	67.00	135	74.46	60.54	44.84	255	186.00	69.00	27.06	615	520.50	94.50	15.37	Includes initial fee, termination fee and secondary sales load.
Financial Independence Founders, Inc., Series D.	60	0	60.00	100.00	120	46.17	73.83	61.53	240	153.27	86.73	36.14	600	482.79	117.21	19.54	Includes service fee, trustee fee, secondary sales load and withdrawal penalty.
Foundation Plan, Inc., Endowment Certificates.	60	0	60.00	100.00	120	27.75	92.25	76.88	240	138.75	101.25	42.19	600	471.75	128.25	21.38	Includes service fee, trustee fee and secondary sales load, and unpaid remainder of sponsor's service fee.
Trusted Income Estates, Series C.	60	0	60.00	100.00	120	41.10	78.90	65.75	240	147.94	92.06	38.36	600	468.47	131.53	21.92	Includes service fee, trustee fee, secondary sales load and remainder of sponsor's service fee.
Individual Assured Estates, Inc., Endowment Trust Certificates.	110	81.86	28.14	25.58	170	126.51	43.49	25.58	290	215.81	74.19	25.58	650	514.20	135.80	20.89	115 months. Includes service and trustee fees and secondary sales load.

Independence fund Trust Certificates.	60	0	60.00	100.00	120	52.06	67.94	56.62	240	153.90	86.10	35.88	600	474.45	125.55	20.93	Includes service fee, trustee fee, secondary sales load, re- mainder of unpaid service fee and \$5 additional withdrawal charge after 1 year.
Fundamerican Trus- teed Certificates.	60	0	60.00	100.00	120	52.54	67.46	56.22	240	160.37	79.63	33.18	600	483.87	116.13	19.36	Includes service fee, trustee fee, secondary sales load and re- mainder of unpaid service fee.
Commonwealth Fund Trust Certificates.	80	13.94	66.06	82.58	140	69.40	70.60	50.43	260	180.32	79.68	30.65	620	508.88	111.12	17.92	Includes service fee, trustee fee, secondary sales load and re- mainder of unpaid service fee.
American Participa- tions, Inc.	60	0	60.00	100.00	120	0	120.00	100.00	240	85.00	155.00	64.58	600	436.00	164.00	27.33	Includes service and trustee fees paid plus unpaid re- mainder of service fee plus \$5 withdrawal fee after 1 year.
Average percent- age.				84.58				59.43				36.71				20.45	

• Dividends and appreciation or depreciation of the fund are not considered.

4. Double Loading Charges

The variety of deductions in the usual installment investment plan presented a confusing appearance to the investor. The \$10-a-month investor could hardly be expected to understand without careful and detailed explanation the "double load" complication of the plan, the system of withdrawal fees, the composition of the "make-up sheet" of the underlying trust shares and the other fees and charges in the plan and the manner of their exaction. The difficulty experienced by certificate holders in ascertaining the nature of the service fee is exemplified by the following complaints listed among the complaints of certificate holders submitted as typical by the installment plan sponsor, Independence Fund of North America, Inc., together with the comment of the sponsor:⁷¹

2. Client did not fully understand service fee or how deducted.

Investigation of many such instances revealed that the client was advised of the total service fee but did not apparently understand that it was all deducted from the first year's payments, although this was clearly set forth in all literature and instructions to salesmen.

3. Client, upon being advised that they could effect withdrawal at any time overlooked the fact that any unpaid service fee would be deducted at the time of withdrawal.

In many such instances we have found that the client was as much at fault in this respect as the salesman. It has been found that clients starting one of these programs have the intention of continuing it, and therefore do not pay enough attention to penalties involved if payments are not kept up, although they are explained by salesmen. These cases are due more to carelessness than to misrepresentation.

The most serious source of difficulty was the exaction of the "secondary sales load" after deduction had already been made for the service fee. The hard task of the sponsor in enlightening the investor as to the "double load" aspect of the installment plan was recognized by Mr. Barton, of Income Foundation, Inc.⁷² In recommending its abolition, he testified:⁷³

A. * * * As to the question of deductions or service fees, it is my personal belief that the single-load trust, or [rather] that the service fee should be included in one item and not part of the service fee and part in a spread between bid and asked.

I know from experience—and this is said frankly—that it is a difficult job to sell in competition with other plans. We show that our service fee is 9 percent. Our competitors, as far as I know, all of them, show a service fee of 5 percent. That is as much as usually gets to or penetrates the mind of the average investor. It is not brought out, naturally, by the competitor, that we have no load for servicing our trust shares, and I don't think it is understood by the investors that the spread between bid and asked, where it is provided in most

⁷¹ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 613.

⁷² Mr. Barton testified (Public Examination, Income Foundation, Inc., at 11663):

A. * * * We considered the matter from every angle. The first conclusion we reached was this, that it would be better to state the load as a fee in terms of a fee rather than, if you want to term it that, disguise the load in the difference between bid and asked, which we found from experience, that in the instances of most small investors, they were not interested.

⁷³ Public Examination, Income Foundation, Inc., at 11708.

other plans of this kind on the trust shares, is recognized as an additional load.

In other words, to summarize, I believe in the single load rather than in the double load or the divided load, regardless of its size. As to what the load should be, I think the evidence today will illustrate that our endeavor has been constantly to reduce cost.

Even if the investor perceived the true nature of the "double load," he was confronted with the task of ascertaining the components of the load. The burden of computing the total amount of charges was placed on the investor rather than on the sponsor by reason of the double load set-up. The actual loading charge on the underlying trust shares was usually higher than the percentage stated as the secondary sales load.⁷⁴ Odd-lot brokerage, ordinary brokerage, transfer taxes, expenses, reserves, and an amount equalizing accumulations and accrued dividends were computed in the price of the shares. The resulting price was frequently advanced to the next higher fraction. Various methods of ascertaining the value of the portfolio securities presented added difficulties. Concerning the investor's understanding of the method of computing the price of the underlying securities, Mr. Barton testified:⁷⁵

Q. Mr. Barton, the make-up sheet here indicates that in making up the price of Independence Trust Shares the amount of odd-lot brokerage, the amount of commissions was included, the amount of accumulations and accrued dividends, and then there was mark-up, to the next highest eighth—

A. The next highest nickel, I think.

Q. Doesn't that all mean * * * that the amount the trustee paid for these shares was more than 9 percent of the value?

A. That is correct.

Q. Was that known to certificate holders? Did you tell them that when you sold them these certificates, that they were paying more than 9 percent, or did you just say there was a 9 percent override?

A. My recollection is we furnished this circular, which was not put out by us, giving the break-down of the load and a description of Independence Trust Shares. What the salesmen told them, I don't know. They probably said—in fact, I think it was quite customary to say, "Well, there is an addition of 9 percent." * * * I don't believe that the average investor would have understood this break-down if he had seen it.

That well-nigh insuperable difficulties faced the average certificate holder who attempted to discover the amount and nature of the secondary sales load is evidenced by the fact that even the president of one sponsor company was unable to explain the details of the computation necessary for the liquidation of the underlying security. When questioned as to how the liquidating value of an account was obtained, Mr. Hughes testified:⁷⁶

Q. Can you tell me what the formula is that is used by you in liquidating the Truited Industry Shares in the account of a Benjamin Franklin Trust Certificate holder who attempts to liquidate his account?

⁷⁴ See the Commission's supplemental report on Fixed and Semifixed Investment Trusts, Ch. X.

⁷⁵ Public examination, Income Foundation, Inc., at 11600-1.

⁷⁶ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 86-7.

A. I would prefer the Treasurer to answer that question, and I think he could give it more accurately and more to your satisfaction. He is available and he is very familiar with it.

Q. Do you know what it is? Could you answer the question?

A. I could stumble over it, but it wouldn't be satisfactory, and you can get it from him.

Q. Let me ask you this: Do you use a basis of liquidation 91% of the offering or selling price established by the T. I. S. Management Corporation as of the date of liquidation?

A. The question is too technical. I prefer Clark or Schryer to answer those questions.

Q. You can't answer it?

A. I would prefer that they answer it.

Q. Can you answer it?

A. No.

The same difficulty was experienced by other officers of sponsor companies. Charles T. Cushman, vice president of Fundamerican Corporation, testified:⁷⁷

Q. Now, Mr. Cushman, will you tell me how the price of the trust shares is created?

A. Well, it is all in the——

Q. Yes; but I want you——

A. We don't create the price; the price is created by the Fundamental Group Corporation, and it is contained in their prospectus.

Q. And the price of the trust shares is computed, as I understand it, by taking the current market price of the underlying securities as of the night before; is that not right?

A. I couldn't say. I can't speak with authority on that.

Illustrating the same point, Robert W. Porter, president of Fundamerican Corporation, testified:⁷⁸

Q. Now, Mr. Porter, we have had complaints from quite a large number of Fundamerican Corp. investment planholders that at the time they purchased the plan they now hold they knew nothing about the 8½ percent loading charge.

* * * * *

I want to ask you, Mr. Porter, if you ever explained the 8½ percent loading charge to salesmen?

A. I can't recall any distinct situation where I did; but I have always, as a matter of policy, brought to the organization's attention the necessity for it. I would say that I had, although I can't recall anything distinct wherein I said it. But, as a matter of intention and as a matter of purpose, I think the question of the load is something that the company wanted thoroughly explained to the subscriber.

Q. And you consider that that is an important part of their sales presentation, do you not?

A. Most important.

Q. Now, Mr. Porter, Mr. Cushman, who testified here on Thursday, wasn't quite definite as to how the price of the trust shares was created. Can you explain that to me?

⁷⁷ Hearings *In the Matter of Fundamerican Corporation* held on November 10, 1938, pursuant to order for investigation dated September 23, 1938, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 439.

⁷⁸ *Id.*, at 503, 507-8.

A. How the price——

Q. Yes.

A. Bid or the asked?

Q. The asked price of the trust shares.

A. The asked price. Well, as explained in the make-up sheet in the prospectus, where the various daily prices of the securities are shown, and to that are added the 8½ percent, and divided by the number of units, which determines the daily quotation.

Q. The 8½ percent is added after the brokerage fee and the odd-lot differential are added to the current market price of the underlying securities, is it not?

A. I don't know. I couldn't tell without referring to the sheet.

Q. Well, that is what it says in the prospectus.

A. If that is it, all right.

Paul F. Myrick, vice president and secretary of Income Estates of America, Inc., admitted that the explanation of the computation of the value of the underlying trust shares was "rather complicated."⁷⁹

Certificate holder after certificate holder asserted that they had no knowledge or did not understand the double loading charge in the installment plan.⁸⁰ The following statement of one certificate holder will serve to illustrate this lack of understanding:⁸¹

I did not realize, and it was not explained to me that the above deductions would be made, and that the balance, whatever it might be, would be invested by the Pennsylvania Company for Insurances on Lives and Granting Annuities in a security known as "Trusteed Industry Shares," or that Trusteed Industry Shares is an investment trust security of an investment trust known by the same name, i. e., Trusteed Industry Shares, which is sponsored and managed by T. I. S. Management Corporation, and that there is a trustee for Trusteed Industry Shares separate and distinct from the Pennsylvania Company for Insurances on Lives and Granting Annuities. In other words, I was given no information and had no knowledge whatsoever that the Benjamin Franklin Foundation "plan" is in effect a trust on a trust with two separate trustees and two separate sets of trustee's fees.

Moreover, the double loading charge arrangement almost invariably caused the income of the investor to be subjected to the deduction of a load upon reinvestment. The loading charge upon this reinvestment was another aspect of the installment plan that the astute investor who discerned it would have to take into consideration.

The reason for double loading seems to be historical.⁸² The early installment plan sponsors arranged for the purchase of investment

⁷⁹ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on March 30, 1938, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 67.

⁸⁰ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc., et al.*, United States District Court for the District of New Jersey, In Equity No. E 5877, affidavits of certificate holders.

⁸¹ *Id.*, affidavit of Elizabeth Thimm, sworn to January 24, 1938, p. 4.

⁸² The following testimony of Mr. Geary indicates that double loading charges were an historical outgrowth (*Independence Shares Corporation v. Deckert*, U. S. C. C. A. for Third Circuit, Nos. 7146 and 7147, March 1939, Transcript of Record, at 156-9):

Q. Tell the Court what was the purpose, why you needed that second company? You explain those functions, if you will, of the two companies; that would probably help us.

A. Independence Trust Shares is an investment trust of the semi-fixed type. It was in existence prior to the formation of Capital Savings Plan. It was sold and distributed through dealers, E. H. Rollins and Jones, Janney and Company, and

trust shares issued by independent firms. The usual loading charge was computed in the acquisition price of those shares purchased for the installment plan certificate holder as in the price of shares sold to any other investor.

The early installment plan, Independence Fund Participation Agreements, utilized North American Trust Shares, 1953, as its underlying investment medium. Independence Fund of North America, Inc., sponsor of this plan, received a $4\frac{1}{2}\%$ participation in the secondary sales load of approximately 9% on these trust shares. This participation in the sales load was not retained by the sponsor but was passed on to the certificate holders. Mr. Simonson explained the practice as follows:⁸³

Q. Let us follow \$10; let us take the first \$10 that was paid in. What happened to it? The first went to you, didn't it?

A. It first went to us. We bought North American Trust Shares, 1953, deposited them with the Empire Trust Company.

Q. Just before you go on. You bought North American Trust Shares, 1953, from Distributors Group?

A. From Distributors Group; yes.

Q. You bought them at what price?

A. We bought them at the asked price prevailing at the time of purchase, less $4\frac{1}{2}\%$.

Q. That deduction of $4\frac{1}{2}\%$ was made at that time, was it?

A. Yes.

Q. So the investor received shares for what?

A. He received the shares at the asked, net, less $4\frac{1}{2}\%$.

About one year later, Independence Fund of North America, Inc. originated a new installment investment plan called Independence Fund Declarations of Trust. This plan had Cumulative Trust Shares as the underlying security. In this plan the sponsor received an even greater discount from the total secondary sales load of $9\frac{1}{2}\%$. This

others. It was distributed all over the United States, California, New York, out through the middle west, Pennsylvania, and the eastern seaboard.

Capital Savings Plan was formed in order to give investors the opportunity to buy Independence Trust Shares on a monthly basis and have those shares held for them by a bank, for the bank to reinvest the semiannual distribution, and as the investor made payments the investor's account was credited with Independence Trust Shares which through the machinery of the Trustee was carried out to the fifth decimal point, which meant that all funds for investment were fully invested.

When you are dealing in a two dollar—as a matter of fact, in the early days the price was a good deal higher—when you are dealing with a higher priced stock, let us take the price of \$4, to buy with a \$10 payment other than two shares was not possible. Under this plan that was gotten out with the Pennsylvania Company it was possible to have that money fully invested after, of course, the allocation for the payments and fees that were called for.

Those plans called for payments of \$1,200 over a period of ten years, and they also gave the investor the right to withdraw his trust shares at any time during the length of the plan, or he could terminate the plan whenever he wanted. It was his property, not ours. We merely built up and offered him a convenient method of acquiring these shares over a period of years.

Q. You charged 9%, $7\frac{1}{2}\%$ went to Capital Savings Plan and $1\frac{1}{2}\%$ to Independence, because Independence had some overhead?

A. Yes. I would like to point out to you that prior to the time we took over and maintained Independence Shares Corporation, Independence Shares Corporation were retaining 3 per cent. and paying Capital Savings Plan 6 per cent. of the 9; they kept 3 and paid out 6. When we took over Independence Shares Corporation we paid ourselves no salary and we broke the thing down to the most economical operating unit, and in that way we kept $1\frac{1}{2}\%$ percent. in Independence Shares and paid ourselves in Capital Savings Plan $7\frac{1}{2}\%$ per cent. In other words, the purpose was to have the Independence Shares Corporation cover its cost of doing business only through the $1\frac{1}{2}\%$ per cent.

⁸³ Public Examination, Independence Fund of North America, Inc., at 6521.

amounted to $5\frac{1}{2}\%$ at first, and 8% shortly thereafter. However, the sponsor retained this participation and did not pass on the benefits of the discount to the investors. It may be observed that the primary service fee of the sponsor which had been \$120 for a \$1,200 certificate under Independence Fund Participation Agreements, was reduced to \$60 for a \$1,200 certificate under the new plan. Mr. Simonson testified:⁸⁴

Q. Apparently you cut down in your service fee from \$120 in this plan to \$60, from \$120 in the first plan to \$60 in this plan. Is that right?

A. That is right.

Q. However, that \$60 was made up by the $5\frac{1}{2}\%$ which was later raised to 8% , being the secondary load on the trust shares. Is that right?

A. I would say that is approximately correct, because we do give our dealers $2\frac{1}{2}\%$, or our distributors or branch offices $2\frac{1}{2}\%$ of the 8% .

Q. So far as the investor is concerned, your load was heavier on the second plan than on the first plan, wasn't it?

A. It was approximately the same. Figured this way— 10% of the participation agreement, plus 5% on the underlying, made a total of 15% . In the other one we had 5% or \$60 plus about 8% in the amount invested in the trust shares and the balance of $2\frac{1}{2}\%$ trustee's fee. So there might be a half percent difference.

Q. Out of this load you got a larger share?

A. Yes. We are speaking about to the investor?

Q. Yes. But you as a company got a larger share?

A. I think we did. I would say so.

Q. When you increased the percentage that you got in the secondary load from $5\frac{1}{2}\%$ to 8% , you did not attempt to pass that on to the investor, did you?

A. No.

Q. Did you take it up with them at all? Did they know you were getting that increased load?

A. Of course it was set forth in our prospectus since the Securities Act has been in effect as to what we received.

Q. But not before that?

A. No.

Apparently this sponsor had some motive for reducing its service fee from \$120 to \$60 and for retaining the discount on the secondary sales load. One inference, for which there is strong justification in the absence of any other reasonable explanation, lies in the lack of understanding of the double loading on the part of the installment plan subscriber—the desire to minimize or “disguise”⁸⁵ the true load.

This inference is likewise applicable to other sponsor companies, and is substantiated by the fact that a “double load” arrangement was created or permitted in cases where the installment plan sponsor was also the depositor or distributor of the underlying fixed trust or management company, or affiliated with them, or in cases where the underlying securities were a portfolio of common stock. Since the installment plan sponsor controlled or issued the underlying investment medium, there was no obstacle to the deduction of the sponsor's charges as a single fee directly from payments made by subscribers directly, instead of a partial deduction from payments and a partial

⁸⁴ Id., at 6584.

⁸⁵ Public Examination, Income Foundation, Inc., at 11661.

deduction in the form of a load in the price of the underlying shares or the participations in the underlying fund.

In any case, to the extent that the secondary sales load was purely a sales load, it was unjustifiable. The sale of the underlying security was accomplished as soon as the sale of the plan was completed. The latter was inclusive of the former. Since a "selling job" was not required in connection with the underlying security, it was anomalous to impose a second sales load.

The duplication of selling costs in the installment plan was stated by Mr. Barton, president of a large installment plan sponsor company, to have been "uneconomic." Commenting on the "double load" aspect of the installment plan, Mr. Barton testified:⁸⁶

A. Now, we considered the profit derived by the sponsor of the Trust Shares an uneconomic load, at least, so far as our picture was concerned. For instance, Calvin Bullock received 9 or 9½ percent, reallocated us 5, and retained 4½ percent as their selling profit. They were not doing a selling job, so far as we were concerned. In other words, we were put in the same category as investment dealers which had to be sold by Calvin Bullock's organization and for which they were entitled to that profit, but selling them to us we were doing all that selling job. Therefore, there was 4½ percent selling cost borne by the investor which we considered could and should be eliminated.

The proportion of the secondary sales load that was purely a selling charge and not a charge for services rendered in connection with the purchase, custody, liquidation, and auditing of the underlying security, may be determined by the share of this load received by the installment plan sponsor. Mr. Geary indicated that only 1½% of the value of the underlying securities was the actual cost to the depositor of fixed trust shares for its services in creating them.⁸⁷ T. I. S. Management Corporation, the depositor of Trusteed Industry Shares, which was the underlying security of six plans, retained only one-tenth of the secondary sales load as compensation for its services.

The "double load" has been dispensed with in some instances despite the fact that an independent underlying security was purchased for certificate holders.⁸⁸ The depositor or issuer of the underlying security, in these cases, receives its remuneration out of the primary sales load charged by the sponsor of the installment investment plan. Thus, the "double load" is not a necessary arrangement.

5. Double Loads, Hidden Loads, and Profits to Sponsor

In the fixed and semifixed investment trusts, 19 different sources of profit to the companies sponsoring fixed trusts existed, besides the published loading charge included in the selling price of the trust shares.⁸⁹ Most of these sources of profit to the fixed trust sponsor

⁸⁶ Id., at 11662.

⁸⁷ See note 82, supra.

⁸⁸ Reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Item 23. Recently, several installment plan sponsors have abolished the secondary sales load (Securities Registration Statement for Financial Independence Founders, Inc., File No. 2-3594, filed with the Securities and Exchange Commission, February 1, 1938, post-effective amendment filed March 22, 1939, Items 25 and 42; Securities Registration Statement for Income Estates of America, Inc., File No. 2-3687 filed with the Securities and Exchange Commission May 6, 1938, Items 25 and 42).

⁸⁹ See the Commission's supplemental report on Fixed and Semifixed Investment Trusts.

caused a diminution in the equity value of the underlying trust shares to investors, among whom were included the bulk of installment investment plan certificate holders. The installment investment plan certificate holder was subject, however, to the possibility of further loss by reason of practices on the part of the installment plan sponsor, whereby the sponsor obtained profits from sources other than direct primary fees and secondary loading charges.

a. "REVOLVING FUNDS"

Accounts maintained by the sponsor to supply underlying securities for the installment plan and facilitate liquidation of the certificate holder's investment furnished one method for securing such profits.

For convenience in providing securities for acquisition by the trustee on behalf of the certificate holders, the sponsor deposited investment trust shares or shares of common stocks in an account from which the trustee could fill its requirements. This account, termed a "revolving fund" or "escrow account," also contained cash funds which were used to pay certificate holders in exchange for shares or participations.⁹⁰

Certificate holders who liquidated their holdings were paid a "liquidating value" by the trustee which was usually based upon the market value of the portfolio securities, less ordinary brokerage, odd-lot brokerage, taxes, and expenses allocable to those securities. Actually such commissions and expenses were not paid by the trustee since the participations or trust shares of the withdrawing certificate holders were retained in the "revolving fund" or "escrow account" and were transferred directly to the accounts of those certificate holders making payments. On these latter transfers, commissions and expenses were again charged although no expenditures had been made for such purposes.

Thus, trust shares and participations could be transferred repeatedly and commissions and expenses assessed on each transfer with no actual expenditure. The profits derived from the differential charged were kept by the sponsor and not turned over to the certificate holders.⁹¹

Walter H. Schryer, treasurer of Benjamin Franklin Foundation, Inc., testified concerning the matter as follows:⁹²

Q. Now, I understand you have an escrow account?

A. Yes.

⁹⁰ As has been indicated, the tendency has been for withdrawing certificate holders to liquidate their holdings for cash, and not to withdraw the underlying trust shares.

⁹¹ Mr. Simonson testified (Public Examination, Independence Fund of North America, Inc., at 6588):

Q. What is that revolving fund with the trustee for?

A. The revolving fund of the trustee is \$6,000, and it is used by the trustee to purchase shares from liquidating subscribers, always in the fractional amounts, and sometimes or many times, we might say, in the full amount of the liquidation of the withdrawing subscriber.

Q. How much money did you get out of that fund? Do you know?

A. The figures are not compiled as yet. I would say generally that the money made on the revolving fund, which was primarily made by two factors—one being the difference between the price at which we purchased the shares and the asked price.

⁹² *Hearings In the Matter of Benjamin Franklin Foundation, Inc.*, held December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 12, 14–15.

Q. Can you describe to me the operation of that account?

A. We have a certain number of shares—first of all we start out with fifty shares, we get fifty shares from T. I. S. and deposit them with the Pennsylvania Company. That account is used for adjustments and for liquidations. In other words, if a customer decides to liquidate his account the Pennsylvania Company will sell us the shares involved at the day's bid price. Then they credit our escrow account.

* * * * *

Q. In other words, the shares are purchased from the escrow account at the same price they would be purchased from T. I. S.?

A. Yes.

Q. And they are sold to your escrow account on the same basis that they would be sold back to T. I. S. Management Corporation?

A. That is correct.

Q. Therefore, you make a profit on your escrow account?

A. Well, we do; not because we want to but because we have to handle it that way. We don't intend to take a position on it and we do it for the convenience of the certificate holders because otherwise it would take five to ten days to get those shares liquidated through T. I. S. Management Corporation, and they can do it overnight in our account.

While the "revolving fund" or "escrow account" may have been a convenience in the operation of the plan, profits were obtained by the sponsor by making a charge for expenses which were not incurred. One installment plan indenture made express provision covering a "revolving fund" arrangement by which the differential was awarded to liquidating certificate holders.⁹³

b. "SWITCHING" OR EXCHANGES

When the installment plan sponsor created a new plan, it generally endeavored to induce holders of certificates under the old plan to exchange them for certificates under the new plan. Such exchanges often resulted in profit to the sponsor and loss to the investor, by the exaction of another "secondary sales load" on the exchange of the underlying trust shares.

Mr. Simonson admitted the payment of a second load in such an instance.⁹⁴

Q. Now, you exchanged with the people who had the Participation Agreements, your first plan, into this plan, didn't you?

A. To the extent of \$1,591,100.

Q. And through that exchange there is made a gain there by you? Didn't you make that gain?

A. We waived our service fee entirely, and the only profit that resulted to us was through the spread that existed between—not spread, but rather the

⁹³ The provision is as follows (reply to the Commission's questionnaire for United Fund Accumulative Certificates, Series TA, Exhibit A, p. 5): "* * * the Certificate Holder may * * * liquidate his account at current market value, less authorized deductions, including the proportionate brokerage, if any, necessary to liquidate certificate holder's account; however, every effort shall be made by the fund manager to save said brokerage by paying liquidation from incoming funds or from cash in the fund."

⁹⁴ Public Examination, Independence Fund of North America, Inc., at 6598-9, 6602-3. By 1936, only 3% of the total certificates sold in this plan remained outstanding; the rest were withdrawn, canceled, or exchanged.

discount which we received from the sponsor of Cumulative Trust Shares on purchasing those for the new Fund.

* * * * *

Q. What I am pointing out is that the investor paid a double load, in switching over to these new shares.

A. That doesn't apply as far as service fees are concerned, because we waived that.

Q. That might be true.

A. And it does not apply to trustee's fees, either.

Q. It does not apply to that?

A. No.

* * * * *

Q. But you had a lower service on the second Plan, in lieu of your getting the 8 percent, so that to that extent there was a double load, it seems to me, on the exchange.

A. The investor didn't have a full load on North American Trust Shares. He only paid the load on those to the extent the funds were invested. In other words, he only paid up to the amount invested, and to the amount that was reinvested.

Q. There was the second load?

A. There was the second load; yes.

In this instance, therefore, certificate holders who accepted the exchange offer paid a secondary sales load on the new underlying trust shares, although they had already paid such a load on the old trust shares. Mr. Simonson asserted that this double load was called to the attention of certificate holders:⁹⁵

A. * * * I would like to call attention to the fact, too, that in advising these people of this change I think we called attention to the fact that there was a load on the Trust Shares, so that a profit might result to the company by reason of it.

Q. Well, I would like to offer in evidence at this time the letter announcing the opportunity for the exchange. Will you identify this, please, as having been submitted by you?

A. I identified these and would like to quote this sentence from one of the letters: "The only compensation we will receive by reason of this exchange is a commission from the sponsors of Cumulative Trust Shares, out of which we will pay legal fees, original issue tax on the Trust Certificates, and business expenses incurred by the exchange."

Therefore, we made it clear to the investor at the time of exchange that there would be a commission accruing to us on this exchange.

It is to be noted that the quotation from the letter which purported to disclose the "double load" aspect of the exchange does not state that the "commission" was to be deducted from the certificate holder's account. In fact, it states that the "commission" would be received from the sponsors of Cumulative Trust Shares. Clearly only the more perspicacious investor could glean from this information that his investment would be subject to additional deductions.

Another type of "switching," involving merely a change in the underlying trust shares, also resulted in the imposition of a second load

⁹⁵ Public Examination, Independence Fund of North America, Inc., at 6603-4.

on the certificate holder. For example, when Financial Independence Founders, Inc., shifted the underlying trust shares used for its plan from "Corporate Trust Shares" to "Diversified Trust Shares 'D'" the original certificate holders were solicited by the sponsor to exchange their holdings for the newly selected trust shares. On this transfer a "secondary sales load" was again deducted from the certificate holder's account.

Mr. Thomas conceded that the investor's fund was subjected to the second charge:⁹⁶

A. What you asked me about before, and on which I testified there was a charge made, was that in an account that had accumulated a certain amount of Corporate and had authorized the future payments on an uncompleted account to go into Diversified, those people were given an opportunity to exchange the accumulated Corporate Trust Shares for Diversified, and in many cases they did and we did make a profit on it.

Q. You did make a profit on it?

A. Yes.

* * * * *

Q. But you solicited them to get out of the Corporate Trust Shares into this Diversified D?

A. That is right. We recommended that they make that exchange, and we did make a profit on it.

Q. Did you attempt to get their consent to dispose of the Corporate Trust Shares? That really was your responsibility, wasn't it, that you had chosen a vehicle for them that hadn't turned out very well? Did you ever make any attempt to make this switch over, as you did in previous cases, without any charge?

A. Well, now, I cannot answer that because that was done prior to the time I came there. Mr. Reilly testified that on the previous switches and on the changes of certificates and all that sort of thing the expenses were borne by the company.

* * * * *

Q. So that when you had an improvement in the trust situation you had given the investors the advantage of that, and, as you say, in this case you didn't give that advantage to them?

A. That is correct. They did not. They apparently regarded it as being a legitimate profit.

Q. Well, do you think it is a legitimate profit? We have had lots of switches in unit trusts, as you know.

A. I would say that it was bad practice to switch from one trust to another, definitely.

The responsibility for choosing the original underlying securities and for creating all the features of the original plan, including those features deemed necessary to be changed, rested upon the sponsor. Despite this fact the sponsor did not assume the burden of making the exchange for certificate holders but, in fact, made an additional profit on the exchange.⁹⁷

⁹⁶ Public Examination, Financial Independence Founders, Inc., at 6380-2.

⁹⁷ Compare Public Examination, Income Foundation, Inc., at 11640-1 and id., Commission's Exhibit No. 1150, indicating that no additional loading charge was exacted on an exchange offer, but that transfer fees, trustee's fees, and service-charge adjustments were paid by the certificate holder.

Mr. Thomas, himself, expressed strong convictions against the abuse of "switching." He testified that he perceived such an abuse in a plan sponsored by a Montreal firm, Canadian Financial Founders, Inc.⁹⁸

Q. What has your connection been with it [Canadian Financial Founders, Inc.], if any?

A. I went up there and took a look at it, and at one time, prior to making an investigation of it, I had a contract to acquire a controlling interest in it. That contract was never exercised.

Q. Why?

A. Well, the company had been run by some men who had sold mining stock through it and had gotten a bad name up in Canada.

They had gone out and traded these people out of the plans they sold them for other securities, and it had just been prostituted so that rather than being an asset it was a liability. So naturally I was not interested in acquiring the interest in that company.

Q. You mean they had traded the people out of these plans and into other shares?

A. Yes.

Q. So you would say in situations of trusts of this sort, that trading the investors out of one investment into another is a definite abuse, isn't it, in most cases?

A. Yes; it is something that can be abused very terribly, I mean.

Q. Yes; because it results in a double load on the investor for one thing.

A. Not only that, but in this particular case it resulted in their getting very inferior securities.

The practice of "switching," however, has continued. As recently as May 1938 Independence Fund of North America, Inc. made an exchange offer to its old certificate holders by which the sponsor obtained additional, immediate profits. Under the terms of this exchange, certificate holders were to secure shares in First Mutual Trust Fund, a common fund of portfolio securities managed by the sponsor, in place of Cumulative Trust Shares which had been the underlying security of the plan theretofore. Certificate holders were privileged to exchange their Cumulative Trust Shares for First Mutual Trust Fund shares without paying the loading charge on the latter amounting to approximately 7% of the offering price. A provision of the exchange offer, however, provided for an exchange fee. This fee was equal to 3% of payments still to be made by the certificate holder under his plan. Thus, the amount of this exchange charge varied, depending on the amount of unpaid payments. In those cases where few payments had been made this charge might run theoretically up to \$36.

The loading charge on Cumulative Trust Shares, amounting to 9½% of the value of the underlying stocks, was higher than the loading charge on First Mutual Trust Fund shares. Nevertheless, the difference did not equal the charge for effecting the exchange.⁹⁹

⁹⁸ Public Examination, Financial Independence Founders, Inc., at 6395-6.

⁹⁹ It may be noted that Cumulative Trust Shares was a fixed trust, while First Mutual Trust Fund was a managed fund.

Thus, under Independence Fund Trust Certificate, Plan C, providing for total payments of \$1,200, the service, maintenance, and loading charges were as follows:

Service fee	\$60. 00
Trustee allowance.....	30. 00
Load on Cumulative Trust Shares.....	110. 52
	<hr/>
	200. 52

Under the new plan into which the certificate holder changed, the service, maintenance, and loading charges, including the charge for effecting the exchange, were as follows:

Service fee	\$60. 00
Trustee allowance.....	30. 00
Load on First Mutual Trust Fund.....	77. 77
Charge for effecting change.....	36. 00
	<hr/>
	203. 77

The difference between the two total charges was small; under either plan, out of \$1,200 paid in, the net amount invested in underlying stocks was slightly less than \$1,000. It must be noted, however, that by means of the exchange the sponsor obtained an immediate 3% payment which otherwise would have been spread over the balance of the certificate holder's plan. If a certificate holder who had made the exchange should withdraw from the plan before its completion, he would sustain a greater loss than if he had not made the exchange.

c. "RELOADING"

The practice of "reloading" or reselling a certificate holder is another variation of the practice of "switching" whereby the investor was given another security in exchange for his original security and the sponsor derived additional or more immediate profit on the transaction.¹⁰⁰

Often a purchaser of a relatively small unit or certificate of an installment investment plan, after payments had been made by him over the course of a period of time so that a considerable equity had been built up in his account, was induced to surrender this certificate in exchange for a certificate calling for larger installment payments and with a larger total amount payable. This new certificate naturally was subject to correspondingly larger fees and charges which were, in accordance with the terms of the installment plan indenture or certificate, deducted from the first few payments made by the certificate holder. Consequently, the equity that had been built up by the certificate holder under his old certificate was almost wholly dissipated by reason of the issuance of the larger certificate.

There would seem to be no advantage to a certificate holder who exchanged his small certificate for a larger certificate that could not

¹⁰⁰ This practice is presently the subject of litigation among other matters in the pending case of *Securities and Exchange Commission v. Foundation Plan, Inc., et al.*, File No. 1-87, United States District Court for the Southern District of New York. The fact that "reselling" occurred was not denied; the issues on the subject only concerned questions of misrepresentations and fraudulent conduct.

be obtained by the purchase of an additional certificate to equal the increased amount. On the other hand, there was a definite disadvantage in that it would be some time before the certificate holder's payments would again be invested to the same extent as in the case where an additional certificate had been purchased.

For example, at the end of two years, the holder of a \$1,200 unit in the plan distributed by Foundation Plan, Inc., would have had approximately \$138.25 invested out of \$240 paid in. If this certificate holder had exchanged his certificate for a larger unit with a total amount payable of \$2,400, his funds would have been subject to a service fee amounting to \$180, deducted from the equivalent of the first 12 payments payable under the plan. Assuming that the certificate holder had been credited with the entire \$240 paid in under his old certificate, as was the procedure, he would only have had \$60 available for the purchase of the underlying trust shares on which there was a secondary sales load of $7\frac{1}{2}\%$. The net amount invested would therefore have been \$55.50.

If the certificate holder retained his \$1,200 certificate and purchased another \$1,200 certificate, he would have had an investment of \$138.25 and out of his succeeding total monthly payments of \$20, \$10 would immediately have been invested in trust shares pursuant to the terms of the first \$1,200 plan and \$10 would have been deducted for the service fee on the second \$1,200 plan. Thus, by purchasing an additional \$1,200 certificate instead of switching to a new \$2,400 certificate, the investor's money would have been invested more quickly and would have greater liquidating value in the event of early withdrawal. It would have taken nine months¹⁰¹ for the amount invested under the \$2,400 certificate to equal the amount invested under the two \$1,200 certificates. In tabular form, the accumulated net amount invested during the first nine months for each of the two methods described is as follows:

Months	Net amount invested when additional \$1,200 certificate was purchased after 2 years	Net amount invested when \$1,200 certificate was exchanged for \$2,400 certificate after 2 years
0	\$138.25	\$55.50
1	148.00	74.00
2	157.25	92.50
3	166.50	111.00
4	175.75	129.50
5	185.00	148.00
6	194.25	166.50
7	203.50	185.00
8	212.75	203.50
9	222.00	222.00

Although eventually the same net amount would be invested under either procedure, the investor would lose the earning power of a large percentage of his investment in the early period of the \$2,400 plan.

¹⁰¹ This is based on the assumption that the service fee was deducted in the first 9 months instead of the first 12 months.

Moreover, the liquidating value of his investment would be less and would cause greater loss in the event of early withdrawal. In cases where the exchange was from a small unit to a unit four or five times as large, the loss on early withdrawal would be correspondingly heavy.

As a result of the practice of "reselling" a certificate holder by the exchange of a certificate with a small total amount payable for a certificate with a larger amount payable, the sponsor obtained service fees immediately that would have been spread over a longer period of time. If early withdrawal occurred in these cases, the sponsor would have obtained service fees that it would never have secured otherwise.

An instance of "reloading" is to be noted, among others, in the affidavit of a certificate holder annexed to and in support of a motion for a temporary injunction in the case of *Securities and Exchange Commission v. Foundation Plan, Inc., et al.*¹⁰² The affidavit of this certificate holder was also obtained by the defendant and appears annexed to papers in opposition to the motion. In this case¹⁰³ the certificate holder had purchased a \$50 monthly plan and a \$1,000 fully-paid plan from the sponsor. The certificate holder paid \$500 in advance under his \$50 monthly plan and subsequently made four additional \$50 payments. Thereafter the certificate holder purchased a \$24,000 certificate calling for payment of \$200 a month¹⁰⁴ and the surrender of his fully paid certificate, amounting to \$1,000, and his \$50 monthly payment plan upon which he had paid \$700. The certificate holder was credited with the entire \$1,700, \$1,600 was applied on the new certificate, and \$100 was refunded to him. The service fees which had been deducted under the previous certificates were refunded and credited to his account and the difference between the liquidating value of the account and the total payments made were contributed by the sponsor and the salesman. However, a deduction of \$1,400 for service fees was made immediately, in accordance with the terms of the indenture, leaving the certificate holder with approximately \$200 to be invested in underlying securities and the privilege of investing a balance of \$22,400 from which \$400 more would be deducted for service fees and on which a secondary loading charge would be levied.¹⁰⁵

In the bill of complaint filed by the Securities and Exchange Commission and in affidavits supporting the motion for a temporary injunction, other instances of this type of "reloading" were alleged to have occurred.¹⁰⁶

d. REINVESTMENT OF CAPITAL RETURNS

Among the distributions on the underlying investment fund of the installment plan were returns of capital on these underlying securities. If such capital returns were distributed to certificate holders, it would

¹⁰² Op. cit. supra, note 100.

¹⁰³ Id., affidavits of Stanislaw J. Wojtasiewicz, sworn to September 20, 1938, and October 14, 1938.

¹⁰⁴ The facts of the resale or "reloading" were not denied. It was alleged that this purchase had been induced by misrepresentations. This was denied by the defendants.

¹⁰⁵ It may be noted that, upon withdrawal, the sponsor could deduct its entire service fee from the equivalent of the first 12 required "deposits," including the initial "deposit." (See the reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit A, at 50-53.)

¹⁰⁶ For example see op. cit. supra, note 100, affidavit of Robert F. Muir, sworn to October 26, 1938, at 3-4.

seem that the certificate holder had unwittingly been compelled to diminish to that extent his interest in the portfolio stocks underlying the investment security which underlay his installment plan certificate. The fees and charges allocable to the purchase of the liquidated securities would have been expended without the purpose of long-term investment having been realized.

Nevertheless, returns of capital along with other distributions were reinvested in the underlying trust shares and subjected to the same secondary sales load charged on purchases made with the certificate holder's original principal. To this extent the certificate holder paid an additional loading charge. There was no segregation of actual expenses and reasonable fees by the sponsors as regards this load.

Regarding this double load, Mr. Thomas testified:¹⁰⁷

A. I never have made any study as to the return of capital. I knew, of course, that the liquidating dividend on Drugs, Inc., was paid out as a dividend, but, of course, we take the dividends and reinvest them right away, anyway.

Q. And when you reinvest them you make the same profit?

A. That we do on a deposit; yes.

Q. So that to the extent that this is principal being distributed, this man is paying a double charge on his principal, because it has never been invested.

A. You could put it that way if the accumulations are properly classified, as a return to capital, which I have never so considered them, that would be true, to the extent that that goes on.

When examined on this phase of the secondary sales load, Mr. Simonson testified:¹⁰⁸

Q. Mr. Simonson, so far as this particular trust is concerned, another feature of it was that on reinvestment the investor was paying a load on the reinvestment of his capital, was he not?

A. Well, in our case 4.5 percent of that load reverted back to the investor.

Q. That is right. But five percent, the load of the Distributors Group under this plan, was imposed upon all distributions, because all distributions were reinvested, and the major part of these distributions, as we have seen, constituted capital. Therefore, under this particular set-up there is a secondary load by Distributors Group upon the constant reinvestment of the investor's capital.

A. Over a period of years it appears that that secondary load to which you referred aggregates about 14 cents per trust share.

* * * * *

Q. \$16.80 over the five-year period?

* * * * *

Then I come back to my original question. He is paying a load of \$16.80 just for the privilege of putting his money into trust shares and taking it out again?

A. No; I would say it was more on the principle of, or the same principle that applies to a tax on profits; if you earn a profit you have to pay a tax on it. This was the case here. This man gets a large distribution in the way of sale of rights, stock dividends, split-ups, and the like, and he has to pay that percentage on that distribution. Had it been that this was the return of the reserve fund that was set up and the eliminations it would be a different principal.

¹⁰⁷ Public Examination, Financial Independence Founders, Inc., at 6357.

¹⁰⁸ Public Examination, Independence Fund of North America, Inc., at 6539-44.

Q. We know a certain part of it was the return of the reserve fund and also that part of it was due to elimination of certain securities later on.

A. Yes; later on in 1932.

Q. So far as that is concerned, he is paying a load for just having his capital go back and forth, isn't he?

A. Reinvested.

Reports to certificate holders concerning income distributions on occasion did not indicate that part of such distribution was merely a return of capital. For example, the report of one installment plan sponsor was as follows:¹⁰⁹

MID-YEAR DISTRIBUTION

To Subscribers of Independence Fund Participation Agreements:

The semiannual distribution paid June 30, 1936, on each North American Trust Share held in your Independence Fund Account amounted to \$0.48 per share. The total distribution derived from your shares was immediately used to purchase additional Trust Shares for your account.

It is by this periodic reinvestment of the income derived from your Participation Account that your interest in a representative group of industrial equities is being constantly increased.

During the past six months the portfolio, as a whole, reflected through appreciation the increasing upward trend of general business activity.

Actually, 73% of this distribution consisted of capital returns.¹¹⁰ When examined as to this report, Mr. Simonson testified:¹¹¹

Q. Well, do you know whether you indicated in your reports when these distributions on these underlying shares were made, whether there was a return of capital or not?

A. It is our policy to take the sheet that is made up by the sponsor, that shows the origin of the total distribution and the break-down of it, and advise the investor as to what makes that up. I have answered your question.

This was the sole explanation offered in connection with this practice.

A recent instance in which the second load on a capital distribution amounted to approximately \$40,000 is disclosed in the case of *Deckert v. Independence Shares Corporation*¹¹² (merged with Capital Savings Plan, Inc., on December 31, 1938). Seven securities contained in the portfolio unit of stock of Independence Trust Shares, which underlay the installment plan, Capital Savings Plan Contract Certificates, were eliminated. Most of the proceeds were reinvested in Independence Trust Shares and were once more subjected to a secondary sales load. The court discussed this transaction as follows:¹¹³

Reference was made to the recent sale of seven of the forty-two securities constituting the portfolio of Independence Trust Shares. The testimony disclosed that in February 1939, upon advice of its investment counsel and upon

¹⁰⁹ Id., Commission's Exhibit No. 602.

¹¹⁰ Id., at 6647.

¹¹¹ Id., at 6648.

¹¹² United States District Court for the Eastern District of Pennsylvania, opinion dated May 18, 1939, Kalodner, J. See *infra* for more complete discussion.

¹¹³ Id., at 20.

the adoption of appropriate resolutions by the board of directors, the Independence Shares Corporation sold seven of the securities in its portfolio. The proceeds of the sale totaled \$662,335.76.

The "values" of these seven securities at the dates they were deposited with the trustee, as determined by Independence Shares Corporation, was \$763,655.33.

The \$763,655.33 was the cost of the securities to the Independence Shares Corporation. The cost to the plan holders was approximately \$820,000.00, since there was a seven and one-half per cent "overwriting" or "load" which the Independence Shares Corporation charged the plan holders. (See page 582, notes of testimony.)

Consequently, as a result of the sale of these seven securities for \$662,335.76, there was a loss to the plan holders of \$158,000.00.

There was still a further loss to the plan holders in this transaction. Independence Shares Corporation, in reinvesting approximately \$550,000.00 of the \$662,000.00 received in the sale (the balance was disbursed in cash to plan holders), charged an "overwriting" or "load" of seven and one-half percent against this \$550,000.00, or approximately \$40,000.00. (See page 321, notes of testimony.)

The net result of the "overwriting" at the time of the original investment, the loss in the sale of the securities, and the second seven and one-half percent "overwriting" charge was a loss to the plan holders of close to \$200,000.00—or approximately twenty-five percent of the amount they paid in.

In discussing this transaction, no criticism is intended of the sale of these seven securities, since there was no evidence that there was an abuse of discretion on the part of investment counsel or of the Independence Shares Corporation. With respect to The Pennsylvania Company, &c., under the terms of the trust agreement with the Independence Shares Corporation, it had no say or part in the sale of the seven securities.

While no criticism of the elimination of the seven stocks,¹¹⁴ as the court states, may be made without evidence of an abuse of discretion, the possibilities of abuse in this practice and the "double load" aspect of the transaction are self-evident.¹¹⁵

e. LOAD ON CAPITAL RETURNS

Not only was there a load on the reinvestment of capital distribution, but, in some instances, there was a load on the capital distribution itself. Thus, in a plan sponsored by Independence Fund of North America, Inc.,¹¹⁶ the sponsor was entitled to a fee of 20% of distributions on the underlying fund in excess of 6%. To the extent that

¹¹⁴ The stocks of the following companies were eliminated: Bankers Trust Company of New York, Borden Company, Consolidated Edison Company of New York, New York Trust Company, Philadelphia National Bank, Security First National Bank of Los Angeles, National Biscuit Company.

¹¹⁵ In recognition of the inequitable nature of a second load upon the reinvestment of money for which a load had been paid upon the original investment, one installment plan indenture contained the following proviso (reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit A, at 46): "* * * all cash and/or other property constituting any portion of the net proceeds obtained from the elimination of the stock of an Underlying Company * * * shall be invested in Trust Shares at a price, less any amount paid in respect to accumulations, of which not more than 2½% shall constitute issue and deposit charges, and/or other commissions for the Company, and/or United Endowment Foundation, Inc."

¹¹⁶ Reply to the Commission's questionnaire for Independence Fund Participation Agreements, Item 23.

distributions comprised returns of capital, the sponsor actually received an additional fee, taken from the certificate holder's original principal. Mr. Simonson recognized the difficulties in this situation. He testified:¹¹⁷

Q. After there had been a return of over six percent to the investor, you got 20 percent? Isn't that right?

A. Of the excess.

* * * * *

Q. And the fact is that you took that 20 percent up one year and then you abandoned it?

A. No; we never abandoned it because it was a provision in the certificate, but during one year that 20 percent represented an income of about a thousand dollars.

Q. What was the return that year?

A. It was in excess of six percent. It was just fractionally in excess of six percent.

Q. As a matter of fact, under your agreement you were entitled to take it on these distributions of principal and income. Is that not correct?

A. That is correct. That is the reason why we passed the resolution of our Board of Directors setting forth we would not take it in any instance where there was a return of capital involved, figuring the distributions were out of income and eliminating any return of capital from our calculation.

Q. So that so far as you were concerned you recognized that difficulty of distributions of capital and income from these North American Trust Shares?

A. That is correct.

It must be noted, however, that the elimination of capital returns from the calculation was purely voluntary on the part of the sponsor.

Deductions directly from distributions of income were common under the terms of many plans.¹¹⁸

f. TRADING PROFITS—"INSIDE" PURCHASES

Another source of revenue was found by sponsors in cases where the investment medium used for the plan was investment trust shares for sale in the open market. The sponsor on occasion could purchase these shares for the requirements of the installment plan at a lower price than that obtainable from the usual source of supply—the sponsor or depositor of the investment trust. A profit was thus made by the installment plan sponsor in excess of the commission it ordinarily received on purchases. This profit was not passed on to the investor. Mr. Barton testified:¹¹⁹

A. * * * Originally we were buying shares from the Depositor Corporation, receiving a commission. Later on we began to buy them on the open market, and we got a bigger spread sometimes buying in the open market than we did from the Depositor Corporation—so that the profit really wasn't due to a rise in the shares held in the escrow account.

Q. But, in any event, if you did purchase in the open market in that manner, the lower price you got was not passed on to the——

A. Not passed on to the investor.

¹¹⁷ Public Examination, Independence Fund of North America, Inc., at 6545-6.

¹¹⁸ See Table 7, *supra*.

¹¹⁹ Public Examination, Income Foundation, Inc., at 11637-8.

When examined on the disclosure to certificate holders of profit of this nature, Mr. Barton testified:¹²⁰

Q. What you had been doing on the Independence Trust Shares up to that time was you had been making a profit on the actual purchases of the trust shares in the open market?

A. That is correct.

Q. What was stated to the certificate holders when they purchased a certificate? They knew about your participation in the loading charge on Independence Shares, but did they know about your purchases of the Independence Trust Shares in the market and your profit there, which was really, I suppose, a trading profit?

A. That was of very little interest, it seems to me, to investors. The chief thing they were concerned in was what price they paid. They paid the asked price, and the asked price was computed as set forth in this circular.

Q. But they didn't know about the other profit.

A. I should say that the sophisticated ones knew about it.

The installment plan sponsor, Bank and Insurance Shares, Inc., was able to purchase securities for its two installment plans at so-called "inside" asked prices, and obtained a differential between those prices and the prices specified in the installment plan indentures amounting to as much as 2½% of the value of the portfolio stocks at times. Generally this differential was 1½%.¹²¹

Ordinarily the installment plan sponsor could obtain trading profits only by assuming the risk of market trend in taking a long or short position in the underlying investment medium used in the plan. However, in some instances it was possible for the installment plan sponsor to obtain trading profits without any risk on its part and with a resulting loss of increment to the fund of the certificate holders.¹²² This could be accomplished by a sponsor or distributor who, under the terms of the indenture, could choose one of two or more prices at which trust shares or participations would be sold to the certificate holders. This choice was made possible because of a "time lag" between the determination and effectiveness of the price for any particular day.¹²³

The following quotation from the prospectus of First Mutual Trust Fund, the fund underlying Independence Fund Trust Certificates, explains the time lag as well as the manner in which trading profits

¹²⁰ Id., at 11647-8.

¹²¹ Derived from supplementary information supplied the Commission for Bank and Insurance Shares, Inc.

¹²² Thus, Allan N. Young, president of Income Estates of America, Inc., an installment plan sponsor company, testified (Hearings *In the Matter of Income Estates of America, Inc.*, held on June 30, 1938, pursuant to order for investigation dated April 19, 1938, under section 19 (b) and Section 20 (a) of the Securities Act of 1933, at 20) :

Q. Has your company ever taken long-and-short position in the underlying medium of investment?

A. Yes; we have.

Q. Is that fully disclosed in the various prospectuses?

A. Yes; it is.

¹²³ For a detailed discussion of the manner in which T. I. S. Management Corporation, sponsor of Trusteed Industry Shares, conducted such riskless trading operations, see the Commission's over-all report, Pt. Two (House Doc. No. 70, 76th Cong.), Ch. III, Sec. III, B, 3, and the Commission's supplemental report on Fixed and Semifixed Investment Trusts. See also *In the Matter of T. I. S. Management Corporation*, 3 S. E. C. 174 (1938).

may be obtained by the sponsor (although the sponsor stated that it did not intend to make such profits):¹²⁴

Under normal circumstances the public offering price is determined each business day as soon after the close of the New York Stock Exchange (3:00 P. M.) as is possible, which is generally around 4:00 P. M., and becomes effective as of 3:00 P. M. that day, and remains in force until the next price is determined, which under ordinary circumstances would be as of 3:00 P. M. of the following day. Between 3:00 P. M. and 4:00 P. M. (or until the offering price has been determined) no orders are confirmed. Any orders received during that time are confirmed at the new offering price when determined. By reason of this fact, it is possible, if at any time after the termination of the valuation until the next regular valuation at 3:00 P. M. the following day for security prices to advance substantially and for any person, including the Company, Investment Dealers, and General Agents distributing such shares, to acquire shares before three o'clock on that day at the price prevailing after the previous day closed which may be less than the price at the close of the current day and to this extent there may be a diminution of the Fund which would be borne pro rata by the outstanding shareholders. Conversely, if shares are purchased on any day based upon the previous day's closing price and during such day the value of the securities comprising the Fund decline as of the close (3:00 P. M.), then and to that extent that such difference would exist the shareholders in the Fund would benefit pro rata. The Company has never and does not intend to ever engage in such practice, nor has any Investment Dealer or General Agent engaged in such practice to its knowledge.

Aside from trading profits, the opportunity for brokerage commissions on the part of brokers and brokerage firms affiliated with the installment plan sponsor existed in the cases of those plans which directly or indirectly controlled the sales and purchases of the portfolio securities.¹²⁵

The problem of excessive trading, however, is not a problem peculiar only to the installment plan, and the problem is discussed in the Commission's over-all report on investment trusts and investment companies.

g. PROFITS FROM INSURANCE PREMIUMS

As pointed out, insurance premiums were deducted from certificate holders' payments at the same rate for all certificate holders. This

¹²⁴ Securities Registration Statement of First Mutual Trust Fund, prospectus dated May 12, 1938.

¹²⁵ Public Examination, Income Foundation, Inc., at 11681-2. Mr. Barton, while denying any excessive trading in the course of the management of the investment fund underlying his own installment investment plan, testified that the practice of excessive trading in order to secure greater commissions might exist in the industry:

A. Mr. Wallace Lanahan and his partner, Mr. Hobbs, are the other two Trustees. They are both investment brokers. One we term a stock man, the other we term fundamentally a bond man.

Q. They are in the investment banking business?

A. They are in the investment banking business.

Q. Do you make your purchases of securities through them?

A. We do. The only thing they derive out of this is the ordinary commission or brokerage, New York Stock Exchange Commission. That is a New York stock house.

Q. You buy all your securities through W. W. Lanahan and Company?

A. We buy all except our insurance stocks. We have no contract; there is no understanding, directly or indirectly. We can buy them from anybody. There isn't any reason I can see why they shouldn't be purchased through Lanahan and Company. I can see, of course, and which I understand in some instances has been done, a great deal of trading in and out has been engaged in so that they could make higher commissions, but I think our records show that that is not the case.

sum was based upon an average rate for the group, apparently taking into account average age and experience of mortality. In some cases, while premiums were collected on this basis, they were paid to the insurance companies on the basis of actual age or other data. Since the sponsors of these plans were careful to fix the rate high enough to cover actual premiums paid to insurance companies, an excess of deductions for insurance often remained in these cases for the profit of the sponsor.¹²⁶ Of 20 comparable plans with insurance provisions, 9 plans indulged in this practice. The aggregate amount of the excess of payments by certificate holders over payments to insurance companies, came to \$15,432 up to December 31, 1935. No figures are available after that period.

B. EFFECT OF SIZE OF MONTHLY INSTALLMENT PAYMENTS

The installment investment plan was offered to subscribers for as little as \$5 a month.¹²⁷ The usual minimum payment was \$10 a month. These small payments enabled the installment investment plan sponsor to attract subscriptions from individuals who might not be in a financial position to invest or speculate in common stocks. The heavy rate of lapses indicates the difficulty experienced by sub-

¹²⁶ When questioned on this matter, Mr. Barton testified as follows (Public Examination, Income Foundation, Inc., at 11603-5) :

Q. What was the purpose of running all the insurance premiums through the Income Foundation, Inc.?

A. Well, the payment of insurance was a contingent liability on Income Foundation, Inc., for this reason; Income Foundation, Inc., agreed that in the event of a death to make up unpaid installments. To protect its guarantee and to assure the trust holder of its liability to meet that guarantee, it agreed to take out insurance with a reputable insurance company and assign that insurance to the trustee. To further protect the investor's interest, the amount that was estimated it was necessary to cover the insurance premiums was deducted by the trustee and held in escrow, and it was the duty of the trustee to pay those insurance premiums as the bills were rendered.

I might add that the amount of the premiums was based on age, and after consulting with the insurance companies, they advised that we should base our insurance cost or charges on the average age of 45. It is impossible, obviously, to take each person's age each month, so we charged everybody on the basis of the age of 45. That is the way the insurance charges were deducted, and they were held by the trustee. In some instances, a man would pay in advance. Naturally the insurance had to be deducted for those months in advance he paid, and whether he paid or didn't pay, the insurance premiums had to be paid. It was possible the deductions might not be adequate or enough to take care of the insurance. The age rate might run up for some unknown reason. Therefore the money held for that purpose was a contingent asset on Income Foundation, Inc., and is offset as a liability or carried through our balance sheet as a contingent liability. So, although the money was held by the trustee, it was carried through our balance sheet.

Q. Actually you have made some slight profit from the insurance?

A. Some slight profit has been made. Well, we don't know whether that is a profit or a loss. We can't tell until the end.

Q. You just said all these premiums were calculated upon the basis of the age of 45. What justification is there for someone, say 22, who comes in and takes a certificate, paying a rate of insurance calculated on age 45?

A. The only justification is this; it is the only practical way it can be handled. You can't calculate every individual contract holder's age and make a deduction to cover his specific age. If we could calculate that, we would like very much to have done it. In that event we would never have had any risk at all.

Q. In any event, all these people who have certificates, who are under the age of 45, are paying more for their insurance—

A. Whose average age through the life of the trust is under 45 will pay more than the man whose average age is over 45. In other words, some pay less and some more.

Q. Yes; but the people under 45 throughout the life of the plan are paying more for their insurance than they should?

A. That is correct, but that, I think you will find, is common practice in most group insurance. It is only common practice because there is no other practical way of handling it. You can't calculate every certificate holder's age, month by month, and charge him accordingly. The trustee would have a hopeless job in making the proper deductions.

¹²⁷ Replies to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Exhibit A; United Fund Accumulative Certificates, Series TA, Exhibit K.

scribers in continuing the plan, and the fact that such lapses were accompanied by heavy losses to these investors renders the problem of serious concern.

Illustrating the type of investor to whom the \$10-a-month plan appealed, Mr. Barton, in discussing a change from 120 months to 180 months as the period for making payments, stated:¹²⁸

A. * * * If you will remember, our old unit of sale was a minimum of \$1,200. This one we made a minimum unit of sale of \$1,800. We first contemplated a minimum payment of \$15 monthly. That would have carried it out of the reach of a very large class of people who can only afford to pay \$10 a month, so we said in order to enable them to take it up, we would increase the period of accumulation to 15 years. That is 180 payments.

Q. Wasn't there another reason for that, and that is the fact that it is much easier to sell a person something where he pays \$10 a month for 180 months, than to sell him something where he pays \$15 a month for 120 months?

A. You can look at that two ways. The minute you raise from \$10 to \$15, you eliminate a great crowd of people who are unable to save \$15 a month.

Q. You were selling merchandise, and you wanted to sell as many people as you could?

A. Correct. If we had limited it to \$15 a month as the minimum payment, we would have reduced that potential field of operation by just the number of people who cannot save that difference. You would have narrowed it down.

Henry G. Simonson, who asserted that he had originated the installment investment plan to fill an economic necessity for the small investor who wishes to supplement his savings and insurance programs with an investment program, admitted that some installment plan subscribers should not have been induced to undertake a long-term program such as the installment plan.¹²⁹ Officers of other sponsors admitted the same fact.¹³⁰ According to Mr. Simonson, his company insisted that salesmen make it clear to purchasers that they should put their money in a savings bank if they felt that they could not make payments throughout the period, or at least through the seventh, eighth, or ninth year.¹³¹ The effectiveness of such insistence, however, naturally depended to a large extent upon the ethical principles to which a particular salesman subscribed. On the other hand, there was every incentive for the salesman to close the sale, regardless of an early lapse on the part of the subscriber. His commission was practically entirely derived from the first few payments of certificate holders.¹³²

Furthermore, these investors in the low income bracket could scarcely be called financially informed. It has been alleged that the officer of one sponsor company stated "We sell the ignorant class of

¹²⁸ Public Examination, Income Foundation, Inc., at 11666-7.

¹²⁹ Derived from supplementary information supplied the Commission for Independence Fund of North America, Inc.

¹³⁰ Hearings *In the matter of Benjamin Franklin Foundation, Inc.*, held on December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 15.

¹³¹ Op. cit. supra, note 129.

¹³² See Ch. V, *infra*, Problems and Defects in Distribution.

investor.”¹³³ It was upon this group of persons that “salesmanship” would be most effective.

In injunction proceedings brought by the Commission against installment plan sponsors, affidavits of certificate holders in support of motions for temporary injunctions were filed in the district court. These affidavits covered various types of alleged misrepresentations made by salesmen.¹³⁴ It is not necessary, however, for the purposes of this report to ascertain whether misrepresentations were in fact made to these certificate holders. Of at least equal significance is the ascertainment of the type of person who purchased these certificates, what he understood about the nature and implications of his investment, and, indeed, whether he realized at all that he was making an investment in stocks which fluctuated in market price.

Certificate holders actually believed that they were putting money in a savings program; that payments on the installment investment certificates were tantamount to deposits in a savings bank; that withdrawal of their funds could be accomplished without loss; that their funds were safe, guaranteed, and protected; that they were assured of a return of their money together with a certain profit; and that they would receive a definite “maturity value” in 10 years. Many of these \$10-a-month investors apparently thought they were “saving” their money when they made payments to the installment plan trustee because the trustee was a banking institution.

Thus, one certificate holder stated:¹³⁵

The principal reason why I agreed to purchase my Benjamin Franklin Foundation Trust Certificate, above mentioned, was because [the salesman] told me that I could withdraw any moneys I might pay in under said Trust Certificate at any time I might desire to do so.

Another thing which the salesman told me, which induced me to purchase my Benjamin Franklin Foundation Trust Certificate, above mentioned, was that the so-called Benjamin Franklin Foundation “Plan” operated in the same manner as if I were depositing my money in a bank.

In addition, I was influenced to purchase said Trust Certificate because [the salesman] told me that, provided I completed all of my 120 monthly installments of \$10 each, my Trust Certificate would then be worth the sum of not less than \$2,000. He advised me that my Benjamin Franklin Foundation Trust

¹³³ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc. et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavit of Charles B. Green, sworn to February 4, 1938, at 22. The following letter sent to the sponsor of an installment plan by investment counsel for the underlying fixed trust indicates the regard in which the certificate holder's knowledge of financial matters was held (id., Exhibit No. 64): “Enclosed is letter which I think ought to cover the case. Some way or other I wish you could caution your men not to promise 20% capital gain every year and not to promise that the portfolio of this trust will retain its full market value during a depression when stocks and other property are depreciating in value. The poor ignorant investor should be made to understand that no investment counsel is good enough to hold the market up for his clients while it goes down for everyone else. Also we ought not to be held out as the best investment counsel in the country. There is no such animal.”

¹³⁴ In a similar proceeding, *Securities and Exchange Commission v. Foundation Plan, Inc.*, which was contested and is still pending, the misrepresentations alleged in the affidavits of certificate holders were denied.

¹³⁵ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc. et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavit of Alice Wurzbacher, sworn to January 21, 1938, at 2.

Certificate would mature at this figure, namely, \$2,000, not later than 10 years from the date I purchased said Benjamin Franklin Foundation Trust Certificate, provided, of course, that I completed all of my monthly installment payments, and that the certificate might mature at the sum of \$2,000 within 8 years.

Representative statements of other certificate holders are as follows:

The main reason why I purchased said trust certificate was the fact that [the salesmen] informed me that at any time I would be able to get my money back in full. I had already told [the salesmen] on several occasions that it would be impossible for me to invest any money at the time inasmuch as my father had just died and I was the sole support of my mother. The trust certificate was sold to me with the thorough understanding that at any time I could get the entire amount back.

* * * * *

It was represented to me by the foregoing representatives of the Benjamin Franklin Foundation, Inc., that the so-called Benjamin Franklin Foundation "plan" was a "savings fund." My belief, based upon the representations and statements made to me by [the salesmen], aforesaid, was that my money, which was to be sent to the Pennsylvania Company for Insurance on Lives and Granting Annuities, was being lent to the "Pennsylvania Company" (the "Pennsylvania Company" being well known to me as an old established banking institution in the City of Philadelphia, Pennsylvania), and that the "Pennsylvania Company" would use it to invest in various stocks so that I was assured of the return on my principal at any time, plus whatever earnings the "Pennsylvania Company" would have been able to obtain from the use of the monies that had been sent in to it by myself and other holders of Benjamin Franklin Foundation trust certificates. I did not know that the "Pennsylvania Company", after receiving my deposits, would make the above mentioned deductions, which would be turned over to the Benjamin Franklin Foundation, Inc., and that thereafter it would invest the balance in investment trust certificates known as Trusteed Industry Shares. I did not realize, nor was I informed at the time by these men that the so-called Benjamin Franklin Foundation "plan" was in effect a trust on a trust with two separate sets of trustees and two separate sets of fees.¹³⁶

The reason why I purchased the above-mentioned Benjamin Franklin Foundation trust certificate was because I desired to make a safe investment for the benefit of my little boy, who is a subnormal child. Both [the salesmen] represented to me that the purchase of a Benjamin Franklin Foundation trust certificate was a safe investment, and they stated, "Well, Mrs. Thimm, if we wouldn't be all right, if this thing wouldn't be right, it is impossible, because we don't handle your money. The money goes in the Pennsylvania Bank, and this is one of the oldest banks in Pennsylvania. It is over sixty years old." Because of this statement, I was led to believe and did believe that the monies I would pay in under the above-mentioned Benjamin Franklin Foundation Trust certificate were on deposit in the Pennsylvania Bank. My belief in this regard was strengthened because [the salesmen] told me that I could get my money at any time I wanted it.¹³⁷

First of all, he gave me the usual sales talk about preparing for the future. I had just gotten married and I thought it would be a pretty good investment

¹³⁶ Id., affidavit of John R. Wood, sworn to January 20, 1938, at 2-4.

¹³⁷ Id., affidavit of Elizabeth Thimm, sworn to January 24, 1938, at 3.

for it was supposed to carry with it an insurance policy on my life in the amount of \$1,000.

* * * * *

It was also stated to me by this representative that I could get my money back at any time; that if I happened to be out of work and did not want to take it back I could leave what I had paid in lie there until I was employed again, and could start all over.¹³⁸

I will make no further payment as planned—as I do not feel it worth while to again lose my money, and I am certain that you will agree with me, that a man making a small living as I am—am entitled to protection for the few pennies he can save. If I were earning \$10,000 a year instead of \$50.00 per month—perhaps I would be willing to gamble \$1,800. But now I can't do it. Thanking you for reading this letter—and trusting that you will understand just how I feel in this matter, and that you will send me my \$15.00 and in the future—tell your salesmen not to make false statements in order to make a sale.¹³⁹

I asked [the salesman] at the time I agreed to take out a certificate whether or not it was for speculation purposes, and he said: "No; definitely not." In plain English, at the time I agreed to take out the certificate I asked [the salesman] if I put in \$10.00 today, whether in two days' time I could go down to the Benjamin Franklin Foundation and draw that out, the same as in a bank, and he assured me that I could.¹⁴⁰

The reason why we purchased the above-mentioned Benjamin Franklin Foundation trust certificate, above mentioned, was because [the salesman] told us that the "plan" was just like putting our money in a bank. He told us something about a trust, but the way he explained it to us was that the money we paid in, plus the money paid in by other purchasers of Benjamin Franklin Foundation trust certificates, was going into one big pile, and the interest would go up and that we would earn 13% on our money. He never mentioned anything about stocks. Nor did he explain to us that the Benjamin Franklin Foundation "plan" is in effect a trust on a trust, with two separate sets of trustees and two separate sets of fees. The only thing [the salesman] told us was that the "Pennsylvania Company" would receive our deposits and would handle everything.

Another statement made by [the salesman] which induced us to purchase the above-mentioned Benjamin Franklin Foundation trust certificate was that we could take out any monies we might put in at any time we might need it.

From the above statement made, I definitely believed that I was depositing my money in a bank, and that I could withdraw such monies, plus accumulated earnings, at any time.¹⁴¹

I was under the impression, from the statements made to me by [the salesman] that I was lending my money to the Pennsylvania Company so that it could purchase stocks and bonds, and that whatever profit it would make it would return to the holders of Benjamin Franklin Foundation Trust Certificates plus the money I and other purchasers of Benjamin Franklin Foundation Trust Certificates had paid to the said Pennsylvania Company. The reason why I believed this was because [the salesman] told me that the Pennsylvania Company was a company that invested my money for return in investments, and he further told

¹³⁸ Id., affidavit of Charles F. Lake, sworn to January 20, 1938, at 2-3.

¹³⁹ Id., Exhibit No. 132-134.

¹⁴⁰ Id., affidavit of William J. Burgess, sworn to January 22, 1938, at 2.

¹⁴¹ Id., affidavit of Minnie Cilsick, sworn to January 24, 1938, at 2-3.

me that the plan was like a "savings plan"—just like putting my money in a bank or in a building and loan society."¹⁴²

He represented this certificate as being a savings plan, and I understood from his statements that it was similar to making deposits in a savings institution such as the Post Office Savings Department. He further represented that if I subscribed to the plan he was selling I could withdraw any part or all of the monies I might pay in at any time I might desire to do so.¹⁴³

I had quite a discussion with [the salesman] about the merits of the thing. The first thing I asked him was this: "If we paid in our money for a length of time and we found we couldn't pay any further, could we get our money back?"

And he said: "Yes; there will be no trouble about that at all."¹⁴⁴

By reason of the small monthly payments, the installment plan certificates could be sold to persons who required an insurance policy and relied upon the insurance provision of the installment plan, not realizing that it was a decreasing, term-insurance policy covering only the unpaid portion of their plan. One certificate holder stated that he was employed as a porter at a salary of \$35 a month and that he desired to take out an insurance policy on his life at the time he purchased an installment plan certificate.¹⁴⁵ He stated that he "thought this trust certificate carried with it a life insurance policy on my life." After purchasing the certificate the certificate holder endeavored to secure a return of his money and spoke to the salesman. His affidavit stated:¹⁴⁶

I told him that I could not continue making payments of \$10 per month, because I was making only \$35.00 per month salary, and that I wanted my money back. [The salesman] then informed me for the first time of the fact that \$8.00 had been deducted from each one of the monthly installments I had sent in.

One certificate holder testified as follows with respect to the insurance provision of his plan, indicating his lack of understanding concerning it:¹⁴⁷

Q. And you knew that part of the money you paid in would be deducted to pay the premium on that life-insurance policy?

A. No; I didn't know anything about that.

Q. You know if you take out a life-insurance policy you pay a premium on it, don't you?

A. Yes.

Q. And you knew that you had a life-insurance policy in connection with your plan, didn't you?

A. Yes, sir.

Q. And you knew that part of what you paid in would be deducted to pay that premium, didn't you?

A. That wasn't explained to me that way.

Q. I know; but you knew enough from your own knowledge of life insurance and the fact that you had to pay premiums for them——

A. I know.

¹⁴² Id., affidavit of Alfred Melos, sworn to January 26, 1938, at 4-5.

¹⁴³ Id., affidavit of Wilbur P. Ricket, sworn to January 10, 1938, at 1.

¹⁴⁴ Id., affidavit of Maurice L. Rippe, sworn to January 20, 1938, at 2.

¹⁴⁵ Id., affidavit of William Joseph Walsh, sworn to January 26, 1938, at 1.

¹⁴⁶ Id., at 4.

¹⁴⁷ *Independence Shares Corporation v. Deckert*, U. S. C. C. A. for Third Circuit, Nos. 7146 and 7147, March 1939, Transcript of Record, at 171-2.

Q. And you knew that if you got life insurance here you would have to pay a premium upon it, didn't you?

A. It wasn't explained to me that way.

By the COURT:

Q. Did you know it or didn't you know it?

A. I knew there was insurance connected with it.

Q. Did you know you were paying for the insurance?

A. No; I was paying \$5.00 for the Capital Savings.

Another certificate holder testified as follows:¹⁴⁸

Q. What else did he tell you?

A. And he told me that it was a safe investment, and I didn't have to worry, and that if I didn't want to save after two years I could get my money, and if I did change my mind about it I could get my money; but he said before two years I wouldn't be able to get the full amount, but after two years I would.

Q. Then what else did he tell you about it?

A. I can't remember everything.

Q. Did you buy a contract with or without insurance?

A. I bought a contract with insurance.

Q. What did he tell you about that?

A. But he didn't tell me anything about paying the insurance; I mean I didn't understand anything about that. I thought the policy enabled you to be insured.

Other certificate holders made the following statements in connection with this feature of the plan, showing how little informed they were as a class:

It was represented to me that the insurance feature meant that in the event of my death before the ten years were up, my beneficiary would get the face value of the said trust certificate, namely, \$3,000. In other words, it was represented to me, and I believed that my life was being insured for \$3,000.¹⁴⁹

These two representatives told me that it was a savings plan. I asked [the salesman] if it was like a building and loan association and he said "sure." He also advised me that the "Pennsylvania Company" was in back of it. He also told me that I could withdraw any monies I might put in at any time I might need them. In addition, he told me that at the end of ten years the certificate would mature at the sum of \$2,000. He also advised me that the trust certificate carried with it insurance which covered me in the amount of \$2,000, in case of death.¹⁵⁰

The reason why I purchased the above-mentioned Benjamin Franklin Foundation Trust Certificate was because [the salesman] the representative of the Benjamin Franklin Foundation, Inc., led me to believe that the purchase of said trust certificate was a safe and sound investment in a company that was more or less of an insurance company. In other words, I thought the trust certificate I was purchasing was like an annuity whereby The Pennsylvania Company for Insurances on Lives and Granting Annuities was guaranteeing the payment to me of the sum of \$2,000 at the end of ten years, provided I completed all of my \$10 monthly installment payments.¹⁵¹

¹⁴⁸ Id., at 188.

¹⁴⁹ Op. cit. supra, note 135, affidavit of Ferdinand W. Nyemetz, sworn to January 24, 1938, at 3.

¹⁵⁰ Id., affidavit of John O'Hagan, sworn to January 21, 1938, at 2-3.

¹⁵¹ Id., affidavit of Ernest Salvatore, sworn to January 21, 1938, at 2-3.

They also advised me with reference to this trust certificate that the insurance "feature" connected with said trust certificate would mean that all I had to do would be to pay in my monthly installments as called for and that if I died, my little son would receive \$2,000 or more. In other words [the salesman] represented to me and I believed that under the particular type of Benjamin Franklin Foundation trust certificate I was purchasing, my life was insured in the amount of \$2,000 or more, whereby if I were to die at any time during the ten years that I would be making payments under said trust certificate, my beneficiary, namely, my little son, would receive the cash sum of \$2,000 or more.¹⁵²

However, the principal thing that induced me to purchase the above-mentioned Benjamin Franklin Foundation Trust Certificate was because [the salesmen] told me at the time that by purchasing said Benjamin Franklin Foundation Trust Certificates I was taking out an insurance policy on my life whereby my family would be paid the sum of \$2,500 under each trust certificate in the event of my death. As a matter of fact, the Benjamin Trust Certificates that were sold to me by [the salesmen] were type M certificates, carrying with them no insurance feature of any kind whatsoever. I here assert that I never would have purchased said Benjamin Franklin Foundation Trust Certificates except for the belief that I was purchasing insurance.¹⁵³

An indication of the income group mainly sold by installment plan sponsors is revealed in Table 13 showing the size distribution of installment plan certificates. Approximately two-thirds were in units of \$1,200, that is, the \$10 monthly plan. Almost 10% were in units of \$600.

TABLE 13.—*Number and total amounts payable on certificates of 29 installment investment plans,^a classified by amount payable on certificate, 1935*

Amount payable on certificate (in dollars)	Number of certificates in force, Dec. 31, 1935			Amounts payable on certificates in force (in dollars)		
	Fully paid	Periodic payment	Total	Fully paid	Periodic payment	Total
600 and less.....	1, 104	2, 468	3, 572	591, 000	1, 457, 000	2, 048, 000
601-1,200.....	1, 043	23, 043	24, 086	1, 005, 000	27, 117, 000	28, 122, 000
1,201-1,800.....	124	2, 758	2, 882	182, 000	4, 013, 000	4, 195, 000
1,801-2,400.....	141	3, 420	3, 561	295, 000	8, 122, 000	8, 417, 000
2,401-3,600.....	83	1, 914	1, 997	247, 000	6, 306, 000	6, 553, 000
3,601-4,800.....	15	350	365	62, 000	1, 592, 000	1, 654, 000
4,801-6,000.....	55	635	690	288, 000	3, 730, 000	4, 018, 000
6,001-12,000.....	19	301	320	189, 000	2, 957, 000	3, 146, 000
12,001-24,000.....	3	51	54	69, 000	678, 000	747, 000
24,001 and over.....	2	28	30	76, 000	822, 000	898, 000
Total.....	2, 589	34, 968	37, 557	3, 004, 000	56, 794, 000	59, 798, 000

^a This table is based on all plans for which replies to the questionnaire were filed, with the exception of Accumulating Investment Plan Subscription Certificates, Prudential Assured Estates, National Assured Estates, and Selected Managements Fund, Inc.

From the information furnished to the Commission by the installment plan sponsors concerning the occupational status of certificate holders, no conclusions concerning the number of certificate holders

¹⁵² Id., affidavit of Elizabeth Thimm, sworn to January 24, 1938, at 5.

¹⁵³ Id., affidavit of James Toland, sworn to January 28, 1938, at 2-3.

in the various occupational categories can be drawn. The range of occupational groups, however, was probably broader than in other types of investment securities. While executives, proprietors, and professional groups comprised some of the occupations of individuals to whom the plans were sold, it also appears that certificate holders were housewives, domestic workers, laborers, nurses, stenographers, clerks, and others who had little financial experience or knowledge.¹⁵⁴

C. THE SPONSOR COMPANY

The sponsor company originated the installment investment plan and distributed the installment investment plan certificates. Hence, it exercised the most important functions in the plan. The form, manner of operation, and results of this new investment instrumentality may be directly attributed to whatever ingenuity, capability, and intention the promoters possessed. Even in the operation of the plan, it had an important role, for, although no managerial or supervisory duties were ordinarily required in the plan proper, the task of "servicing" certificate holders was vital to the continuation by certificate holders of their programs of investment.

1. The Functions of the Sponsor

Although the sponsor company was primarily a sales organization, its other functions were important. The important decisions of the installment plan were made at the inception of the plan and by the sponsor. Of utmost importance to the investor was the choice of the underlying security. Likewise, the investors' interests were vitally involved in the selection of a trustee and the adoption of the installment plan indenture containing the terms and conditions that were to govern the rights, obligations, and liabilities of the parties thereafter.

These matters were determined by the sponsor company.¹⁵⁵ The trustee apparently passed upon the terms and conditions of the indenture and the construction of the plan.¹⁵⁶

Alfred W. Geary testified concerning this matter as follows: ¹⁵⁷

Q. If the representation were made that the Capital Savings Plan had, in conjunction with The Pennsylvania Company developed the plan under which the investor purchased his contract certificate, would that statement not be misleading and untrue?

A. Well, The Pennsylvania Company had a good deal to do with the drafting of the agreement.

Q. Toward the development of the plan itself?

A. I would say, very definitely, it had.

¹⁵⁴ Replies to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Insured Investors Series A Certificates, Future Requirements Plan Investment Certificates, Wellington Foundation Trust Certificates, American Participations Certificates, Foundation Plan Endowment Certificates, Independence Fund Trust Certificates, National Trustee Fund Contract Certificates, Item 21c.

¹⁵⁵ See Public Examination, Independence Fund of North America, Inc., at 6531.

¹⁵⁶ Public Examination, Income Foundation, Inc., at 11586.

¹⁵⁷ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on June 3, 1938, pursuant to order for investigation dated February 21, 1938, under Secs. 19 (b) and 20 (a) of the Securities Act of 1933, at 105-6.

Q. So that statement you say would be true?

A. The development of the trust agreement. The Pennsylvania Company had its counsel——

Q. Well, is it not a fact that you really submitted the plan to The Pennsylvania Company for them to make any changes that they saw necessary, acting as trustee?

A. That is correct.

Mr. MUNSON (attorney for Mr. Geary). But they were willing to operate under the plan so it must have been in conjunction with them. I really don't see that that is a misleading statement.

Q. I thought that probably the part you played was to submit your plan to The Pennsylvania Company and that they would decide whether or not they were willing to act as trustee under it, but the development and working out of the plan was your own idea?

A. That is true.

Mr. MUNSON. They were willing to cooperate to the extent of doing business with all your customers and receiving the payments and issuing the certificate, having full knowledge of the deduction.

Mr. GEARY. That is true.

In addition to the creation and organization of the installment investment device, the sponsor company was principal distributor of installment plan certificates either through its own sales organization or through independent dealers. This activity of the sponsor is treated subsequently in this report since it entails a discussion of special problems connected with the distribution of certificates.¹⁵⁸

Other functions, duties, and rights of the sponsor company in connection with the installment investment plan proper common in most plans, are as follows:¹⁵⁹

(1) To execute certificates upon receipt of applications and prepare certificates for authentication by the trustee.

(2) In some plans, to receive payments from certificate holders, to make deductions for its fees, and either to turn over cash or to deliver purchased underlying securities to the trustee.

(3) To order the purchase or sale of underlying securities to be made by the trustee in accordance with the indenture or the discretionary directions of the sponsor.

(4) To designate itself or another person or firm as the agent through whom the underlying securities may be purchased or sold.

(5) To pay the trustee's fees and expenses in plans in which the trustee did not deduct them directly.

(6) To substitute other comparable fixed trust shares or management investment company stock for the underlying security originally selected by it. (This was generally discretionary but in several plans was subject to approval by the trustee.)

(7) To render reports to certificate holders upon request as to the status of their accounts or as to the nature of distributions earned for income-tax purposes. (This function was frequently performed by the trustee.)

¹⁵⁸ See Ch. V, *infra*, Problems and Defects in Connection with Distribution.

¹⁵⁹ Activities of sponsor companies in the capacity of depositor of a fixed trust or issuer of management company stock are not dealt with in this report, being covered elsewhere by the Study.

(8) In a few plans, to compute the value of the underlying fund and the proportionate interests of certificate holders.

(9) To terminate the certificate of a holder thereof who was in default in payments (generally one year) at its option and to require the trustee to liquidate the account and deliver the proceeds to the certificate holder.

(10) To vote the underlying securities.

(11) To make arrangements for insurance coverage for certificates and plans offering such provision. To agree from time to time upon premium rates.

(12) To send notices, letters, or warnings of delinquency to certificate holders, at its option.

(13) To consent to the assignment of a certificate holder's account.

(14) To remove the trustee upon notice and to appoint a successor trustee.

(15) To appoint a successor trustee upon resignation of the trustee, or its removal, or its refusal or inability to act as such.

(16) In some cases, to terminate the agreement and require liquidation of the fund of certificate holders.

(17) To agree with the trustee upon amendments to the indenture and certificates.

(18) To assign all its rights, obligations, and functions to another firm with the consent of the trustee and provided its obligations are assumed by its assignee.

In the main, the mechanical functions of purchasing and selling underlying securities, of the custody of underlying securities, and of the accounting and bookkeeping in the installment investment plan were relegated to the trustee. What little discretion there was in the operation of the installment investment plan, was exercised by the sponsor company.

2. The Nature of the Sponsor Company

a. FORM AND STATE OF ORGANIZATION

The sponsors of all the installment investment plans examined in the study were corporate in form. This type of organization presumably protected the promoters and organizers of installment plans from personal liability in connection with their activities. In fact, many installment plan indentures contained a provision expressly stating that the incorporators, stockholders, officers, and directors of the sponsor company were absolved from any personal liability in connection with the indenture or the certificates.¹⁶⁰

¹⁶⁰ For example, the indenture covering Capital Savings Plan Contract Certificates contains the following provision (reply to the Commission's questionnaire for Capital Savings Plan Certificates, Exhibit A-3, at 20): "No recourse under or upon any obligation or agreement contained in this Trust Agreement or in the Contract Certificates shall be had against any incorporator, stockholder, officer, or director, present or future, of the Company, or of any successor company, by the enforcement of any assessment or by any legal or equitable proceeding by virtue of any statute or otherwise, it being expressly agreed and understood that this Trust Agreement and the Contract Certificates are solely corporate obligations and that no personal liability whatever shall attach to or be incurred by the incorporators or by any past, present, or future stockholders, officers, or directors of the Company or any successor company."

In many installment plan indentures, the sponsor agreed to maintain its corporate existence throughout the life of the plan. It was undoubtedly advantageous to the certificate holder that the sponsor company continue to function. However, this safeguard against the "orphaning" of the installment investment plan was a meager one unless financial adequacy of the sponsor were also assured. In many instances this assurance was lacking.

Of 38 sponsors of 55 installment investment plans, nine were incorporated in New York, eight in Delaware, five in Maryland, four each in Pennsylvania and Missouri, two each in Michigan, California, and Colorado, and one each in Massachusetts and Oklahoma. It may be observed that none of these companies had its principal office or place of business in Delaware and only two in Maryland. Thirteen sponsor companies had their main offices in New York, seven in Pennsylvania, four in Colorado, two in Massachusetts, and one in Minnesota. The nine companies incorporated in Missouri, Michigan, California, and Oklahoma had their offices in those states.

b. CAPITALIZATION AND ASSETS OF SPONSORS

The capital structure of the sponsor companies was simple. A single class of stock, closely held, comprised the usual capital structure. Stock was issued to the organizers and their associates for services rendered, as salaries or commissions, as well as for cash contributions. In some cases, generally in connection with a refinancing transaction, preferred stock was issued to the contributor of the additional funds.

No substantial investment was made by most sponsors upon entering this comparatively new investment field. The installment plan promoter commonly believed that very little capital was necessary to enter the business. The investment instrument they devised required little if any management expense or capital outlay, and only those expenses commonly incurred by sales organizations were anticipated. This may have been based upon an underestimate of expenses and obligations entailed in their undertaking. David W. Barton commented on this situation:¹⁶¹

Q. What was the reason you had to keep making continuous demands for capital from your stockholders?

A. There were two reasons. In the first place, we found the development of the sales organization was much more costly than we had anticipated; we found we had to take on certain salaried men as employees. Then, in addition to that, as the records will show, I think at least in 1932 and again in 1934 it was necessary to revamp or bring out new contracts and legal fees, registration fees, and such matters as that required more capital than we anticipated.

Q. In other words, you did not realize when you started Income Foundation the amount of capital that was necessary to market an investment contract of this type?

A. We had no precedent to go on. It was entirely a new business, practically, and we not only underestimated the necessary capital, but we overestimated the volume of business that could be done.

* * * * *

¹⁶¹ Public Examination, Income Foundation, Inc., at 11563 and 11573.

Q. Now, Mr. Barton, in view of your experience in organizing sponsor investment plan contracts, how much capital do you think a sponsor company should have to go into the business of sponsoring this sort of contract?

A. Well, from my personal experience I would never go into this business without \$100,000 capital, if I had to do it over again.

Q. You think that would be sufficient to take care of the legal expenses, sales expenses, and so forth?

A. The primary expense in developing a sales organization; yes.

The capitalization of most sponsor companies did not equal this minimum figure. The average amount of outstanding capital stock of 22 major sponsor companies at December 31, 1935, was less than \$50,000. As shown in Table 14, the aggregate net amount of capital stock was \$1,077,816 for these companies. These figures may be compared with the amount of certificates sold by these companies and payments received from investors up to December 31, 1935. A total of \$103,000,000 of certificates were sold, on which had been paid, up to December 31, 1935, the sum of \$17,425,300. Averaged among the 22 companies, these figures were approximately \$4,680,000 agreed amount payable and \$800,000 actually paid in. Later figures show a far greater proportion of sales and receipts of payments to capitalization.¹⁶²

The net worth of the sponsor companies was less than their capitalization. As at December 31, 1935, the net worth of the group only amounted to \$817,800, an average of approximately \$37,000 per sponsor company.¹⁶³ It may be observed that these sponsors included various items among their assets, like goodwill and organization expenses, aggregating over \$240,000. Valuations placed upon receivables, investments, contract rights, and advances to salesmen are those of the sponsors and were not independently checked by the Commission.

These figures are significant in illustrating the financial condition of these sponsor companies which undertook to give certificate holders "services" for the life of the plan, usually a 10-year period, in return for substantial fees.

c. INCOME OF SPONSORS

In striking comparison with the capital of the sponsor companies, the aggregate gross income of 22 sponsor companies, embracing the bulk of the industry up to December 31, 1936, as shown in Table 15, amounted to approximately \$6,640,000. This is to be compared with the aggregate amount paid by the public under the plans sponsored by these companies for the same period, a total sum of about \$30,500,000. The gross income of these sponsors was 22% of the total payments by certificate holders. This does not represent the entire load borne by certificate holders, since it does not include the entire secondary sales load and trustee's fees.

¹⁶² At the end of 1936, the average capitalization of 16 sponsors for which data are available was \$46,000. Up to the end of 1936, these 16 companies had promoted sales of installment plan certificates aggregating \$105,392,000 in amount payable, an average of \$6,587,000 per sponsor company. Payments by holders of these certificates during this period amounted to \$26,318,000, an average of \$1,645,000 per sponsor company.

¹⁶³ At the end of 1936, the net worth of 16 sponsor companies for which data are available ranged from \$9,000 to \$106,000. Six companies had less than \$25,000 each; 7 had a net worth between \$25,000 and \$55,000; and 3 had between \$80,000 and \$106,000. The average net worth of the 16 sponsor companies was only \$40,000.

The primary sales load furnished the sponsors with a most substantial part of their revenue. This would be expected, since these fees were levied in the first few years of the 10-year period over which certificate holders made payments, and most plans were in existence a comparatively short period of time by the end of 1936. If these payments continue, the secondary sales load will supply an increasingly larger portion of the sponsors' revenue.

The financial statements submitted by 22 installment-plan sponsor companies for the years from 1930 to 1935 show a net loss for the group in each year. Commissions and other direct selling costs and executive salaries accounted for the major portion of all expenses. For 16 sponsor companies for which detailed information was submitted, commissions and other selling costs constituted 55% of all expenses. Salaries comprised 15% of expenses. The net losses of the sponsor companies were thus due largely to the payment of commissions to salesmen and salaries to directors and officers.¹⁶⁴

TABLE 14.—*Composite balance sheet of 22 sponsor companies, Dec. 31, 1935*

ASSETS	
Cash.....	\$302,450.14
Cash and Security deposits.....	23,900.58
Securities owned.....	352,118.24
Accounts receivable.....	147,372.36
Notes receivable.....	39,398.22
Subscriptions to stock.....	26,649.25
Other receivables.....	47,165.31
Furniture and fixtures.....	47,614.85
Real estate.....	3,554.09
Investments in subsidiaries.....	42,757.77
Goodwill.....	5,920.74
Organization expense.....	243,430.90
Advances to salesmen.....	31,979.44
Other prepaid expenses and deferred items.....	67,665.55
Total assets.....	<u>1,381,977.44</u>
LIABILITIES	
Accounts payable.....	348,830.50
Commissions payable.....	20,786.89
Notes payable.....	115,283.71
Deposits.....	7,037.22
Taxes payable.....	1,452.96
Other accrued expenses.....	57,713.86
Reserve for contingencies.....	13,080.92
Total liabilities.....	<u>564,186.06</u>

¹⁶⁴ Of 16 sponsor companies reporting income data for the year 1936, 9 showed a net profit for the year and 7 a net loss. As a group, these companies earned an average profit of only \$3,200 despite the fact that their average gross income amounted to \$138,700. For 11 companies for which operating expenses were available, executive and office salaries amounted to 16% of gross expenses, and commissions paid to salesmen amounted to 59% of gross expenses.

TABLE 14.—*Composite balance sheet of 22 sponsor companies, Dec. 31, 1935—Con.*

NET WORTH

Capital stock outstanding and subscribed-----	\$1, 077, 816. 30
Deficit -----	260, 024. 92
Total net worth-----	817, 791. 38
Total liabilities and capital-----	1, 381, 977. 44

TABLE 15.—*Sources of income and aggregate gross income of 22 sponsor companies in connection with installment investment plans, 1930-36*

Year ended	Num- ber of plans	Aggregate gross primary sales load	Aggregate gross participa- tion in secondary sales load	Delin- quency charges	Manage- ment fees	Other fees and charges	Aggregate gross income from all sources	Aggregate payments of certificate holders
1930-----	3	\$95, 369. 78				\$101. 22	\$95, 471. 00	\$357, 689. 95
1931-----	8	423, 464. 73	\$5, 694. 46		\$864. 64	356. 35	430, 380. 18	1, 546, 271. 00
1932-----	17	674, 091. 54	53, 273. 00	\$3. 00	1, 678. 21	251. 57	729, 297. 32	2, 241, 502. 03
1933-----	22	650, 016. 18	97, 508. 76	114. 44	4, 261. 71	4, 756. 34	756, 657. 43	3, 338, 518. 36
1934-----	23	801, 099. 04	192, 241. 59	752. 05	9, 462. 70	11, 803. 67	1, 015, 359. 05	4, 504, 466. 49
1935-----	30	907, 694. 06	300, 780. 19	2, 395. 82	13, 652. 78	16, 151. 11	1, 240, 673. 96	6, 471, 689. 02
1936-----	26	1,861,773.78	456, 105. 08	5, 726. 24	23, 343. 68	24, 636. 27	2, 371, 585. 05	12, 067, 500. 07
Total-----		5,413,509.11	1,105,603.08	8, 991. 55	53, 263. 72	58, 056. 53	6, 639, 423. 99	30, 527, 636. 92

3. Background and Experience of Promoters and Influence on Creation of the Installment Plan

The relationship of the sponsor company to the public in constructing an adequate investment medium partook of a fiduciary character. In the creation of the plan, the sponsor, in good faith, was bound to exercise that investment skill and knowledge which it professed to have. Primarily the investor could only rely upon the promoters for the attainment of an adequate investment medium, regardless of how he might actually judge the merits of the plan by reason of the mere presence of the large and reputable banking institution as the trustee. In its publicity the sponsor company held itself out as managed by investment experts and as offering a "scientific" plan to the public. Indeed, this profession of expertness and ability was implicit in the very establishment of the plan.

In view of this fact, the sponsor company might well be expected to have personnel in control who were skilled and trained in the investment business, equipped to handle the public's funds or to create a medium for its investment. To the extent that such personnel was composed of persons trained only in selling, such expectation was not realized. Often this was the fact. In such instances it would be expected that emphasis would naturally be placed upon sales and not on investment.

The organizers who formed these sponsor companies often had no experience with securities except as security dealers, and many did not even possess this familiarity with the investment business. The

background of most of the sponsors of the installment investment plans was essentially one of selling and distributing securities. Some installment plan promoters were individuals who had been connected with the sale of installment plan certificates for other sponsor companies as salesmen or independent dealers.¹⁶⁵

The certificate holder presumably relied upon the good faith of the sponsor in publicly offering the installment investment plan and upon the avowal of investment ability and training implicit in such a public offering of an investment medium.¹⁶⁶ The certificate holder may have equally relied upon the express assurance of investment ability and training contained in statements made in the sales literature of the sponsor companies. A typical statement of this nature, taken from a pamphlet issued by Independence Fund of North America, Inc., is as follows:¹⁶⁷

Assurance of safety of principal and regularity of income from invested capital calls for a highly specialized knowledge and for constant vigilance which must be removed from emotional influences. The individual who is building a fund upon which he and his family may be dependent is not usually equipped with the experience and facilities necessary to assume the responsibility involved. An Independence Fund Living Trust provides constant expert and unbiased supervision of investment and the integrity of bank trusteeship.

Mr. Geary admitted that he made no independent study or research concerning the installment plan as compared with the four alternative forms of investment for small periodic payments of money: insurance endowment policies, annuity contracts, building and loan association shares and savings bank accounts; and that he relied upon his general knowledge of these fields of investment.¹⁶⁸

¹⁶⁵ Three such persons were Frank D. Hughes, president of Benjamin Franklin Foundation, Inc. (Hearing *In the Matter of Benjamin Franklin Foundation, Inc.*, held on December 17, 1937, pursuant to order for investigation dated November 23, 1937, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 28); Alfred H. Geary, president of Capital Savings Plan, Inc. (Hearing *In the Matter of Capital Savings Plan, Inc.*, held on May 24, 1938, pursuant to order for investigation dated April 19, 1938, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 11); Allan N. Young, president of Income Estates of America, Inc. (id., at 41-42).

¹⁶⁶ Public Examination, Income Foundation, Inc., at 11678-9. Concerning the need for investment experience and knowledge in the management of a fund underlying the installment investment plan, Mr. Barton's testimony is interesting:

Q. Mr. Barton, what is your background that makes you feel you are qualified to step in and take over a management fund?

A. My only value to this Board of Trustees is my lack of investment knowledge and experience. That may seem a contradictory sort of a statement, but most men qualified to judge security values and who are constantly dealing in securities daily are market minded. They cannot help thinking in terms of whether if we buy this security it is going to rise in the market. In other words, the whole nature of their training, as I see it, is whether they call themselves investors or bank officials, or what have you, the whole nature of their training is to make money out of the market. Now, the whole fundamental principle, or at least the main fundamental principle of this plan, as I see it, is not to attempt to make money out of the market. The application of this principle to investing equal amounts of money assures an acquisition cost lower than the average market price. In other words, the averages in our trust are working for us, as I see it; the averages in the average investment trust and in most investment institutions are working against them. The reason for that being, the new money for investment on a rising market comes in in volume, and when you have a falling market, that new money virtually ceases.

¹⁶⁷ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 601, at 12.

¹⁶⁸ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on May 24, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 53-4.

The sales aspect of the installment plan apparently exerted an influence on the structure and method of operation of the plan that was frequently opposed to the interests of certificate holders. For example, the plan originally created by Independence Fund of North America, Inc., was altered to eliminate certain matters because they complicated the sales presentation, despite the fact that it was felt that additional protection was afforded by these features. Mr. Simonson testified:¹⁶⁹

Q. Why do you have a separation of the trustee and custodian?

A. Because we felt it gave additional protection to have the participations issued by one trust company and held by another. There were two separate functions performed.

Q. As a matter of fact, those functions were all provided for?

A. Yes.

Q. Didn't both of those things cause great difficulty in the sales material?

A. Yes, I think it complicated the sales presentation. That is why we eliminated them later on.

The effect of the sales factor on the creation of the installment plan and its influence on the sponsor in such creation, is reflected in the following comment concerning the choice of underlying medium by Mr. Simonson:¹⁷⁰

Q. * * * Doesn't that indicate that this averaging is not so important after all?

A. No, I wouldn't say that. It merely means that some people would rather have their funds invested in a composite trust fund that was managed, whereas other people would rather have their funds invested in a fixed group of securities.

Q. And I take it, then, that you sell what the people want?

A. That is correct. If they feel that they want to invest their money in the fixed group, we can't stop them and if they want to invest in the management group, we don't stop them there either.

Q. In other words, regardless of what you think is the best, you are a selling agency primarily, aren't you?

A. I think they are both good. I wouldn't attempt to say which is the best policy.

The practice of "window dressing" may be also noted as being indicative of the essential nature of the installment plan as a sales medium. As was often done in other types of investment company enterprises, individuals who were prominent in banking or business circles were elected to the sponsor's board of directors. These names were conspicuously displayed in publicity distributed by the sponsor.

The use which can be made of the presence on the board of directors of well-known persons is exemplified by the following quotation taken from "Trust-O-Gram," a house publication of Financial Independence Founders, Inc.:¹⁷¹

We are pleased to draw your attention to the addition to the names on the Board of Directors, of Mr. Frank A. Vanderlip, Jr.

¹⁶⁹ Public Examination, Independence Fund of North America, Inc., at 6527.

¹⁷⁰ Id., at 6612

¹⁷¹ Public Examination, Financial Independence Founders, Inc., Commission's Exhibit No. 478, dated July 20, 1936.

It is and will continue to be the policy of this company to add to its Board of Directors individuals who will add to the Company's prestige.

Mr. Thomas of Financial Independence Founders, Inc., testified:¹⁷²

Q. And another thing you emphasized was the fact that Mr. Vanderlip was on your Board of Directors?

A. That is right.

Q. And that was part of your window dressing?

A. It was a sales help, if that is what you mean.

4. Exculpation of Sponsor Company

The terms and conditions of the installment plan indenture were fixed by the sponsor company and the trustee. The certificate holder could not bargain with respect to those terms, even if he read and understood them, because the indenture had been completed before the certificate was offered to him. As a consequence these documents often included provisions purporting to exculpate the sponsor company from all liability in general or from liability concerning specific matters. While these exoneration clauses were not as extensively present as those affecting the trustee, this may perhaps be due to the fact that the trustee was in all cases a financially responsible large banking institution. In 33 installment plan indentures examined, 23 had some provision concerning the exculpation from liability of the sponsor company.

A typical exculpatory provision attempting to relieve the sponsor from liability in general for all of its acts or omissions is the following:¹⁷³

The Depositor [sponsor] shall not be liable for anything done by it, or any order, direction or decision made in good faith in the performance of its duties hereunder, or for any action taken in bona fide reliance on information believed by it to be true; nor for the failure of any issuer of securities deposited hereunder to carry out or support any promise or statement; nor shall the depositor be responsible for any other thing except its own willful acts and omissions and its own gross negligence.

Common exoneration provisions affecting the sponsor and concerning particular matters are as follows:

(1) The sponsor company is not answerable for the default, omission or misconduct of any agent, employee, attorney, investment counsel, appraiser, accountant employed by it, provided they have been selected with reasonable care.

(2) The sponsor is fully protected in acting or omitting to act in good faith upon the advice of or opinion of counsel, or investment counsel.

(3) The sponsor is fully protected in acting upon any document believed by it to be genuine and to have been executed or delivered by the proper party.

(4) The sponsor is not liable for any payments made with respect to taxes or government charges.

¹⁷² Id., at 6436.

¹⁷³ Reply to the Commission's questionnaire for Selected Managements Investment Certificates, Exhibit A, at 20.

(5) The sponsor is not responsible for the validity, enforceability or adequacy of the insurance policy, nor for the solvency of the insurance company.

(6) The sponsor is not liable for the manner in which it exercises its voting privileges.

(7) The sponsor is not responsible for its actions in connection with the elimination and substitution of the underlying securities.

(8) The sponsor is not liable for the validity or legality of the installment plan indenture or certificate, and is released from any liability if prevented by law from taking any act required under the indenture.

(9) The sponsor is not liable in connection with the assignment of a certificate, or the replacement of a certificate.

5. Financial Responsibility of the Sponsor Company

The financial responsibility of the sponsor companies is an important factor to be considered in connection with the installment investment plan.

As pointed out previously, the capitalization of sponsor companies in general was very small. The "orphaning" of the trust fund, resulting from dissolution or bankruptcy of sponsor companies, would undoubtedly result in the liquidation of the fund.

Mr. Barton believed that if the sponsor became defunct, it would mean liquidation and withdrawal for the investor:¹⁷⁴

A. Actually or legally, the continuation of Income Foundation, Inc., as distributor would have no bearing whatsoever on contracts in existence. They could be continued to maturity. The trustee's duty is to see that that is done. As a practical matter, I think if the sponsor sold stock and the trust becomes known as a dead trust, generally people become alarmed; they don't know their rights, and they are inclined to drop it and get out.

Such liquidations have actually occurred. Thus when C. D. Parker & Co., Inc., sponsor of Accumulating Investment Plan Subscription Certificates, went into receivership in May 1935, the installment plan was terminated and the funds of certificate holders distributed.¹⁷⁵ At least six other sponsor companies became inactive after commencing the sale of installment plan certificates to the public.¹⁷⁶ The liquidation and distribution of the certificate holders' accounts in these cases would seem to be attributable to the failure of the sponsor to continue to function, although in the cases of National Assured Estates, Inc., and Prudential Assured Estates, Inc., the termination of the plans was partially due to the resignation of Harriman Na-

¹⁷⁴ Public Examination, Income Foundation, Inc., at 11573-4.

¹⁷⁵ Reply to the Commission's questionnaire for Accumulating Investment Plan Subscription Certificates. In this case, it was asserted that service fees were voluntarily returned to certificate holders. (Ibid.) There is no indication, however, of the loss to certificate holders by reason of other fees and charges, nor were records made available to the Commission showing the value of the securities of certificate holders at the time of liquidation as compared with their payments.

¹⁷⁶ These companies were Assured Income Builders, Inc.; Income Founders Corporation; National Assured Estates, Inc.; Prudential Assured Estates, Inc.; Secured Investors, Inc.; and Southwest Investors, Inc.

tional Bank and Trust Company as trustee after it was placed in receivership.¹⁷⁷

Many installment plan indentures actually provided that the certificate holders' funds were to be liquidated in the event that the sponsor company either became bankrupt, went into receivership, was no longer in existence, or failed to fulfill its obligations under the terms of the indenture.¹⁷⁸

Such "orphaning" or liquidation when certificate holders had already paid for services promised and still to be rendered, would clearly be inequitable, particularly since the "semi-compulsory savings" feature of the plan was held out to be one of the principal benefits of the installment investment plan. The loss might be considerable if the sale of the underlying securities were necessitated at a time when the market was in a period of depression.

In recognition of the fact that the certificate holder when he entered the plan presumably relied upon the assurance that he would be given "service" during the life of the plan, Mr. Barton stated:¹⁷⁹

Q. Well, practically it is true, is it not, that if at the end of 1935 you would have ceased business, that most of these persons who had up to this time paid in the \$828,000 would have ceased making payments?

A. Not necessarily. And in fact, both from the interest of the trust holders and from the interest of stockholders, I naturally gave considerable thought to what we would do if we were unable to raise additional capital and continue to function. I had definite plans of exactly what we would do.

What we would do would be to continue to just have a secretary to continue to send out notices, and to all intents and purposes the sponsor corporation would have been kept alive, the trust holders would have received the same service that they had received, and as far as we could possibly give it to them, the same assurance that the plans were still very much alive and that their rights were being protected.

Such "services," however, would have been purely voluntary. In most plans, notices to certificate holders concerning their accounts or their payments were not required to be given.¹⁸⁰ In any event, if

¹⁷⁷ Replies to the Commission's questionnaire for Assured Independence Plan Trusteed Certificates and Prudential Assured Estates Trust Certificates.

¹⁷⁸ A typical provision of this nature is as follows (reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibit A, at 19): "In event the Company shall for any reason be dissolved, liquidated or wound up, or cease business, or in event the Company shall be adjudicated bankrupt or a receiver shall be appointed to take charge of the property and business of the Company, or in the event the Company shall fail or refuse to do and perform any acts or covenants provided herein to be done or performed by the Company while any Certificates issued hereunder remain outstanding, the Trustee shall make disposition of the Deposited Property within a reasonable time thereafter in accordance with the provisions of Article XI of this Indenture (concerning maturity and liquidation)."

Some similar provisions gave the trustee discretion in terminating the installment plan for the same grounds. For example, see the reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit "A," at 62.

¹⁷⁹ Public Examination, Income Foundation, Inc., at 11574.

¹⁸⁰ Cf. the following provision in an installment plan indenture (reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibit A, at 9): "Section 3. The Company may, but shall not in any event be required to do so, unless otherwise provided by the laws of any State in which any Subscriber shall reside and the Company shall be authorized to do business, issue and mail, or otherwise deliver, to any Subscriber a notice of the due date, either past or future, of any payment or payments on the face

the sponsor failed or refused to continue its functions, there was likelihood that the certificate holders would suffer loss.

Aside from the desirability of the continued existence of the sponsor company in order to service the plan, the possibility of the sponsor's liability to certificate holders is an additional factor pointing to the need for capital requirements for sponsor companies in this field.

Sections 11 and 12 of the Securities Act of 1933 give civil rights of action to purchasers of securities in cases involving violations of the Act, such as sales effected by means of misrepresentation, sales of securities for which no requisite registration statement is in effect or for which registration statements are effective but contain untrue or misleading statements, and sales of securities not accompanied or preceded by a proper prospectus. In an action under these sections, a certificate holder may recover the amount of payments he had made under his installment plan certificate from the sponsor company, against which recovery only the value of his fund could be set off.

By virtue of these sections of the Securities Act, contingent liabilities in amounts equal to payments made by certificate holders over periods of years have been created against many sponsor companies in favor of certificate holders.¹⁸¹ In view of the inadequate capitalization and small net worth of many of these companies, however, certificate holders who might succeed in obtaining judgments against these companies, would have little chance of actual recovery from them. While the funds of certificate holders may be set off against the amount of the payments sought to be recovered in actions brought under the Act, these funds have been substantially less than the amount of the payments. The contingent liability of these companies has, therefore, enormously exceeded their net worth.

Specific instances will not only serve to illustrate this point but will also disclose the small amount of capital ventured by installment-plan promoters as compared with the volume of certificates purchased and payments made by certificate holders.

Income Estates of America, Inc., with capital and paid-in surplus of \$26,461 and net worth of less than \$40,000, according to its balance sheet of May 31, 1938, sold certificates to the public under which aggregate payments of \$5,060,545 had been made from April 1934 to February 1938.¹⁸² A contingent liability to certificate holders under Sections 11 and 12 of the Securities Act to the extent of the entire amount of these payments was listed in the balance sheet of this company.¹⁸³ This contingent liability was set forth in whole or in part by reason of a stipulation in a proceeding before the Secur-

amount of any Certificate or Certificates held by such Subscriber, or any delinquent warnings or notices, provided, always, that the failure of the Company to issue and/or mail and/or deliver any such notice or warning shall not, except to the extent aforesaid, in any wise render the Company liable to the Subscriber or to anyone whomsoever, or affect, alter or change the provisions hereof, respecting default and/or non-payment by the Subscriber."

¹⁸¹ Other rights and remedies against these companies may exist at common law or under federal or state statute law.

¹⁸² Securities Registration Statement for Income Estates of America, Inc., File No. 2-3687, filed with the Securities and Exchange Commission May 6, 1938, Prospectus filed March 18, 1939, at 30-3.

¹⁸³ *Id.*, at 32-3.

ities and Exchange Commission conceding certain deficiencies in the prospectus of Trusteed Income Estates Certificates, Series C,¹⁸⁴ and by reason of the findings and opinion of the Commission in *In the Matter of T. I. S. Management Corporation* (the depositor of the underlying trust shares used in this plan).¹⁸⁵ Both of these proceedings were stop-order proceedings under Section 8 (d) of the Securities Act of 1933. An additional contingent liability was set forth "by reason of the circumstances complained of in the equity suit" instituted by the Commission against the company. This "equity suit" was a proceeding in the federal district court brought by the Commission to enjoin the company and its sales personnel from violating the fraud provisions of the Securities Act with respect to the sale of certificates to the public and from violating the provisions of the Act requiring delivery of a proper prospectus to the purchaser of securities.¹⁸⁶ The company denied the alleged malpractices but consented to the entry of a final decree by the court granting a permanent injunction. The decree was entered on July 22, 1938. The prospectus issued by the company with respect to this contingent liability states:¹⁸⁷

This liability will not exceed the sum of \$5,610,660.00 (the amount paid in by purchasers of these Certificates to July 26, 1938) plus interest thereon. The amount of this liability may be reduced by the liquidation value of the stock or shares held for such certificates which on July 26, 1938, amounted to \$3,168,331.10. This contingent liability represents the maximum amount that could be claimed from the Company up to July 26, 1938, by reason of any violation of the Securities Act of 1933.

As of December 31, 1938, the aggregate contingent liability of this company amounted to at least \$5,610,660, but its net worth had decreased to less than \$20,000.¹⁸⁸

Benjamin Franklin Foundation, Inc., had a net worth of \$18,939 at April 30, 1938,¹⁸⁹ which was approximately the equivalent of the capital contributed by its organizers in December 1935 at the inception of the company.¹⁹⁰ By April 30, 1938, this sponsor had sold certificates aggregating \$4,743,150 in amount payable and under which payments of \$919,380 had been made. The amount of these payments, together with the additional payments made by holders of

¹⁸⁴ The contingent liability by reason of these particular deficiencies amounted to \$1,431,815, which was the amount paid in as of May 31, 1938, by holders of Trusteed Income Estates, Series C.

¹⁸⁵ The contingent liability by reason of the decision in this matter amounted to the entire \$5,060,545 which was the total amount paid in by certificate holders under the several plans sponsored by this company from April 1934 to February 1938.

¹⁸⁶ Op. cit. supra, note 182, at 17 and 33. This suit and similar suits against other sponsor companies are discussed more fully in Ch. V, Sec. B, infra.

¹⁸⁷ Id., at 33.

¹⁸⁸ Securities Registration Statement for Income Estate of America, Inc., File No. 2-3687, filed with the Securities and Exchange Commission May 6, 1938, Annual Report 1938, Item 22 at 10-13.

¹⁸⁹ Securities Registration Statement of Benjamin Franklin Foundation, Inc., File No. 2-3550, filed with the Securities and Exchange Commission December 9, 1937, Amendment filed May 27, 1938, Exhibit Q, at 2.

¹⁹⁰ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on December 17, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 2.

those certificates, was set forth as a contingent liability under Sections 11 and 12 of the Securities Act because of "alleged and/or admitted violations of the provisions of the Securities Act." The facts concerning the alleged or admitted violations are substantially similar to those in the case of *Income Estates of America, Inc.*¹⁹¹

Liberty Thrift Foundation, Inc., which issued capital stock of \$20,100, had incurred a deficit of \$19,676 by March 31, 1938, according to its balance sheet,¹⁹² and its net worth at this time was less than \$500. Nevertheless, it had sold, from May 1937 to March 1938, certificates aggregating \$563,300 in amount payable and under which payments of \$57,995 had been made.¹⁹³ In the balance sheet of this company also a contingent liability under Sections 11 and 12 of the Securities Act was set forth by reason of the stop-order proceedings against T. I. S. Management Corporation, which was the depositor of Trusteed Industry Shares, the underlying trust shares of this installment plan also. This liability amounted to \$50,390 as of February 25, 1938, on certificates sold from May 26, 1937 to February 25,

¹⁹¹ In its prospectus, Benjamin Franklin Foundation, Inc. has stated the following as the basis for the contingent liability (op. cit., supra, note 189, Prospectus filed June 16, 1938, at 23-24) :

(1) It is alleged by the Securities and Exchange Commission that the prospectus of Benjamin Franklin Foundation, Inc., in use prior to June 2, 1937, contained certain deficiencies particularly in view of the findings and opinion of the Securities and Exchange Commission in the Matter of the Registration Statements of *Income Estates of America, Inc.* Securities Act Release No. 1480, involving facts which it is claimed by the Commission are substantially similar to the facts of past sales of Benjamin Franklin Foundation, Inc., securities. These alleged deficiencies are not acknowledged by Benjamin Franklin Foundation, Inc., and liability for rescission or damages has not been established in a court of competent jurisdiction.

(2) During the period from February 26, 1936 to January 21, 1938, Benjamin Franklin Foundation, Inc., participated as an underwriter in the distribution of Trusteed Industry Shares sponsored by T. I. S. Management Corporation as a part of the registration statement of Benjamin Franklin Foundation, Inc., heretofore filed under the provisions of the Securities Act of 1933 as amended. Therefore, Benjamin Franklin Foundation, Inc., those persons who signed the said registration statement and every person who was a director of Benjamin Franklin Foundation, Inc., at the time of filing said registration statement may be liable, under Sections 11 and 12 of the Securities Act of 1933, to purchasers of its Certificates, particularly in view of the Findings and Opinion of the Securities and Exchange Commission in the Matter of T. I. S. Management Corporation, contained in Securities Act Release Number 1689.

(3) In a suit instituted on February 4, 1938, in the United States District Court for the District of New Jersey by the Securities and Exchange Commission against Benjamin Franklin Foundation, Inc., Frank D. Hughes, Walter Schryer, and Edward Tiel Clark, the latter three persons being officers of Benjamin Franklin Foundation, Inc., the plaintiff alleged violations of Sections 5 (a) (1), 5 (a) (2), and 5 (b) (2) of the Securities Act of 1933 by all the defendants and violations of Sections 17 (a) (2) and 17 (a) (3) of said Act by Benjamin Franklin Foundation, Inc., in connection with the public offering and sale of securities issued by Benjamin Franklin Foundation, Inc., referred to in the Bill of Complaint filed in said suit as Benjamin Franklin Trust Certificates, during the period from February 26, 1936, to the date of filing the said Bill of Complaint. On February 10, 1938, Benjamin Franklin Foundation, Inc., admitted that all of the facts set forth in the Bill of Complaint, insofar as they relate to it, were true, except that it had not engaged in the sale of said Trust Certificates since January 21, 1938; Messrs. Hughes, Schryer, and Clark admitted that the Bill of Complaint stated a cause of action, except that they had not engaged in the sale of said Trust Certificates since January 21, 1938, and, without admitting wilful violation, all of the defendants consented to the immediate making and entry of a Final Decree which forever enjoined and restrained the said defendants from, directly or indirectly, selling said Trust Certificates or any security through the use or medium of any prospectus, or otherwise, unless and until there is in effect a registration statement as to such security as required by Section 5 (a) of the Securities Act of 1933 and unless such sales are accompanied or preceded by a prospectus that meets the requirements of Section 10 of said Act; and from engaging in certain other transactions, practices, and courses of business which would operate as a fraud or deceit upon purchasers, as set forth in said Final Decree.

¹⁹² Securities Registration Statement for Liberty Thrift Foundation, Inc., File No. 2-2776, filed with the Securities and Exchange Commission, Annual Report 1938, Amendment filed August 17, 1938, Item 22.

¹⁹³ Id., Amendment filed July 22, 1938, Item 8.

1938, "plus an undetermined amount paid in" on these certificates subsequently.¹⁹⁴

Wellington Foundation, Inc., with issued capital stock of \$40,202 and a net worth of less than \$42,000 as at June 30, 1938, had sold certificates under which payments aggregating \$3,051,505 had been made during the period September 1935 to January 1939 by purchasers of installment plan certificates.¹⁹⁵ By reason of alleged violations of the fraud provisions of the Securities Act,¹⁹⁶ a contingent liability was created against this company, concerning which the prospectus of the company stated:¹⁹⁷

The actual amount of this contingent liability cannot be accurately determined without unreasonable effort and expense. However, the maximum amount of the contingent liability, as of January 11, 1939, is estimated to be \$3,051,505.00, which amount represents the amount paid in by purchasers of these Certificates to January 11, 1939, but which amount is calculated without adding interest at the rate of 6 percent per annum or deducting distributions received by Certificate Holders. The amount of this liability may be reduced by the liquidation value of the shares held for such Certificates which on January 11, 1939, amounted to \$1,742,762.84.

Lexington Foundation, Inc., with issued capital stock and capital surplus of \$26,568 and a net worth of less than \$30,000 as at February 28, 1938, sold certificates under which certificate holders made payments aggregating \$1,509,909 from December 8, 1934, to February 25, 1938.¹⁹⁸ A contingent liability equal to the amount of these payments was set forth under Sections 11 and 12 of the Securities Act of 1933 by reason of the T. I. S. Management Corporation stop-order proceeding.¹⁹⁹ This company was also the defendant in an injunction proceeding brought by the Securities and Exchange Commission in the federal district court to restrain the company and its personnel from alleged violation of the Act with respect to the sale of certificates.²⁰⁰ The company denied the alleged violations but consented to the entry of a final decree permanently enjoining the company and its personnel from violating the Act.

¹⁹⁴ The contingent liability was stated to be offset by the market value of trust shares underlying certificates in force February 25, 1938, which amount was undetermined. As of March 31, 1938, however, the market value of trust shares underlying the outstanding certificates amounted to \$22,043. (Id., Item 22, Schedule 2.)

¹⁹⁵ Securities Registration Statement for Wellington Foundation, Inc., File No. 2-3381, filed with the Securities and Exchange Commission August 30, 1937, Prospectus filed May 1, 1939, at 26-27.

¹⁹⁹ In an equity suit instituted by the Securities and Exchange Commission in the federal district court, the Commission alleged violations of Section 17 (a) of the Securities Act of 1933 by the company with respect to the sale of installment plan certificates. The company filed an answer denying the alleged violations but consented to the entry of a final decree, which was entered by the court on January 11, 1939, perpetually enjoining the company and its personnel from engaging in various malpractices in violation of the Act. This injunction proceeding is discussed more fully, together with others, in Ch. V, Sec. B, *infra*.

¹⁹⁷ Op. cit., *supra*, note 195, at 23-24.

¹⁹⁸ Securities Registration Statement for Lexington Foundation, Inc., File No. 2-3303, filed with the Securities and Exchange Commission July 21, 1937, Prospectus filed March 17, 1938, at 13.

¹⁹⁹ The contingent liability of \$1,509,090 was stated to be offset by the market value of the trust shares underlying the certificates, which on February 25, 1938, was approximately \$697,313. (Ibid.)

²⁰⁰ This proceeding is discussed more fully in Ch. V, Sec. B, *infra*.

Financial Independence Founders, Inc. at December 31, 1938 stated its capital stock to be \$50,030 and its capital surplus \$76,739. Of the book net worth of \$126,769, however, approximately \$113,500 represented organization and development expenses. Thus, this sponsor company owned not over \$13,269 of real assets at the time.²⁰¹ Several contingent liabilities existed against this sponsor also. One possible liability was created by reason of the sale by the sponsor of a number of certificates in excess of the amount for which registration statements had been filed. The total amount payable of such certificates was estimated by the sponsor at \$3,631,565, of which \$318,000 had been paid to June 15, 1938. Investors had demanded and received \$4,080 in refunds of this amount, paid in part by the sponsor and in part from the underlying trust property as a set-off. Another possible liability was created against this sponsor company because of alleged violations of the Securities Act of 1933, which formed the grounds of a bill of complaint in an equity suit for a permanent injunction, instituted by the Securities and Exchange Commission against this company also. Concerning this contingent liability, the balance sheet sets forth the following:

This section may have created a contingent liability of an undetermined amount arising from the claims of the investors concerned in the event any such investors are able to establish whether there was any violation of the Securities Act of 1933 in connection with the sale to them of Financial Independence Founders Certificates.

The contingent liability arose in connection with the sale of certificates from February 1932 to June 1938 and while the amount of possible liability is not available, some idea of the amount may be obtained from the fact that in the period from 1932 to 1938 certificate holders had paid in \$6,348,877 and that at December 31, 1938 certificates were outstanding in the total amount paid and agreed to be paid of \$20,392,152.

Fundamerican Corporation as at May 14, 1938 stated its capital and capital surplus at \$18,545, its liabilities at \$13,217 and its assets at \$31,762. Of the assets, however, \$24,984 represented a "deferred charge" for organization and development. There was apparently only \$5,000 in tangible book assets.²⁰² In the period from 1933 to 1937, certificate holders in the plan sponsored by this company paid in a total of \$644,960. Contingent liabilities, the larger of which amounted to \$126,894, also existed against this company.²⁰³

²⁰¹ Securities Registration Statement for Financial Independence Founders, Inc., File No. 2-3584, filed with the Securities and Exchange Commission, February 1, 1938, Post-effective Amendment filed March 22, 1939, Exhibit Q-1.

²⁰² Securities Registration Statement for Fundamerican Corporation, File No. 2-2016, filed with the Securities and Exchange Commission March 24, 1936, Post-effective Amendment filed December 20, 1938, Exhibit Q.

²⁰³ These contingent liabilities are stated as follows (ibid.):

* * * Between January 1, and June 1, 1938, the corporation sold 49 certificates, Plan A, 44 certificates, Plan B, and 6 certificates, Plan C. The certificates sold were registered with the Securities and Exchange Commission under Registration Statement No. 2-2016, effective May 4, 1936. Under Section 10 (b) of the Securities Act of 1933, as amended, the corporation may be liable to purchasers of these certificates for rescission or damages because the prospectus delivered did not contain statistical information as of a date more recent than 12 months. The principal amount of the above certificates is \$169,300, and the payments to June 28 amounted to \$11,410.

In December 1938, the Securities and Exchange Commission concluded a study of the methods used in certain sales by representatives of the Depositor. As a result

Corporate Leaders of America, Inc., stated its paid-in capital at \$21,330 and its net worth at \$24,723, as at December 31, 1938. An item designated "organization and development expense," included among its book assets, was in the sum of \$13,506. Furniture and fixtures were carried at cost in the amount of \$6,330. Securities carried at a cost of \$21,039 were valued at only \$16,280 in March 1939.²⁰⁴ By December 1938 this sponsor had sold certificates under which payments aggregating approximately \$1,500,000 had been made by certificate holders.

A contingent liability amounting to \$68,925 against Corporate Leaders Securities Company, a related corporation which was merged with Corporate Leaders of America, Inc., on March 15, 1938,²⁰⁵ was assumed by the latter. This contingent liability arose in connection with the sale by Corporate Leaders Securities Company of its capital stock to the public. In a stop-order proceeding under Section 8 (d) of the Securities Act of 1933, instituted in May 1937, the Securities and Exchange Commission found that the registration statement filed by Corporate Leaders Securities Company with the Commission contained false and misleading statements.²⁰⁶ Accordingly a stop order suspending the effectiveness of the registration statement was issued. The major misrepresentation found by the Commission was the statement that the company would engage in a general investment business and would invest in a wide variety of companies, whereas the Commission found that the corporation intended to devote the bulk of the proceeds of the sale of its capital stock to furnish Corporate Leaders of America, Inc., with capital funds. Actually Corporate Leaders Securities Company did invest its funds with the installment plan sponsor and eventually merged with it.

Capital Savings Plan, Inc. had sold certificates under which certificate holders had paid the total sum of \$4,659,156 from 1932 to the end of 1937. The latest balance sheet filed with the Commission for this company indicates that on August 31, 1936, it had a net worth of \$54,706, although its contributed capital was \$90,690.²⁰⁷

In June 1938 this sponsor and its wholly owned subsidiary, Independence Shares Corporation (depositor of Independence Trust Shares) were made the defendants in an injunction suit brought by the Commission similar to the other suits previously mentioned brought against other sponsors for alleged violations of the Securities Act of 1933 in connection with the sale of installment plan certificates. Denying any violations, Capital Savings Plan, Inc. and Independence Shares Corporation consented to the entry of a final decree on June

of such study the Commission concluded that there was reason for it to believe that there were possible violations of sections 5 (b) (1) and 17 (a) (2) (3) of the Securities Act of 1933 as amended, involved in certain sales practices and methods of the Depositor. The Depositor denies the existence of any such violations. Nevertheless, the Depositor determined to discontinue the further sale of any unsold certificates covered by this registration statement. The Depositor may be liable to purchasers of certain certificates for rescission or damages, and the maximum amount of such contingent liability is estimated at \$126,894, although the Depositor disclaims the existence of any basis for such liability.

²⁰⁴ Securities Registration Statement for Corporate Leaders of America, Inc., File No. 2-1777, the Securities and Exchange Commission November 25, 1935, Annual Report 1938, Item 22.

²⁰⁵ The name has been changed to Prudential Fund, Inc.

²⁰⁶ 2 S. E. C. 667 (1937).

²⁰⁷ Reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Table 19, and supplementary information supplied the Commission for 1936 and 1937.

23, 1938, permanently enjoining them and their officers and sales personnel from violating the Act.²⁰⁸

In December 1938 Capital Savings Plan, Inc. merged with Independence Shares Corporation. The balance sheet for Independence Shares Corporation after the merger at February 28, 1939 shows a net worth of \$25,316 (excluding goodwill valued at \$37,759).²⁰⁹ A contingent liability²¹⁰ as at August 31, 1938 was estimated to be in the maximum amount of \$3,486,000 in connection with the sale of trust shares from September 1935 to June 1938 and the alleged violations of the Securities Act of 1933. The contingent liability of Independence Shares Corporation after its merger with Capital Savings Plan, Inc., is, it is believed, substantially greater.

Pertinent to this discussion, it is noteworthy that at least one action has been brought against an installment plan sponsor under Sections 11 and 12 of the Securities Act of 1933. In *Deckert v. Independence Shares Corporation*,²¹¹ holders of Capital Savings Plan Contract Certificates on the grounds of fraud and misrepresentations sought to recover their payments and also sought to have a receiver appointed for Independence Shares Corporation for the purpose of liquidation and distribution of its assets on the claim of its insolvency. A motion to dismiss the complaint was denied and a countermotion for the appointment of a receiver was continued, pending the report of a special master on the question of solvency of Independence Shares Corporation.²¹² An appeal from these decisions is pending at present in the Circuit Court of Appeals.²¹³

D. THE TRUSTEE

The trustee's chief function was to act as custodian of the funds and property of certificate holders. Other major duties involved the purchase and sale of underlying securities pursuant to the indenture or the sponsor's direction, and the keeping of accounts. In all cases, the trustee was a large banking institution or trust company.²¹⁴ In this connection the emphasis placed by sponsors upon the trustee, as well as upon the "trust" aspect of the plan, created much misapprehension among certificate holders as to the exact function and place of the trustee in the plan. This problem is considered in connection with other problems on distribution.²¹⁵

²⁰⁸ See Ch. V, Sec. B, *infra*, for more complete discussion.

²⁰⁹ *Independence Shares Corporation v. Deckert*, U. S. C. C. A. for 3rd Circuit, Nos. 7146 and 7147, March 1939, Transcript of Record, pp. 418-21.

²¹⁰ Securities Registration Statement for Independence Shares Corporation, File No. 2-3679, filed with the Securities and Exchange Commission May 19, 1938, Post-effective Amendment filed December 27, 1938, Exhibit Q.

²¹¹ *Robert J. Deckert et al. v. Independence Shares Corporation et al.*, United States District Court for the Eastern District of Pennsylvania, Civil Action No. 218 (1939).

²¹² *Id.*, opinion of Kalodner, J. In connection with the decision on these motions, the court handed down an opinion dealing with the merits of the action. This opinion and testimony taken at a hearing before the court in connection with these motions are discussed and quoted in this report.

²¹³ United States Circuit Court of Appeals for the Third Circuit, Nos. 7146 and 7147 (March 1939).

²¹⁴ In one instance, the trustee for a plan was an individual. This plan was Southwest Investors Trust Units, now defunct and on which very little information is available.

²¹⁵ See Ch. V, Sec. C, *infra*.

1. Functions of the Trustee

Technically the trustee was more than a mere custodian of the certificate holders' property since legal title to the property rested in the trustee. Actually the trustee was little more than a custodian. Any discretion accorded it in the installment plan indentures was restricted by limitations and based upon contingencies improbable of occurrence. The matters of administration which generally devolved upon the trustee were mechanical in nature and determined by the indenture or the sponsor.

The duties commonly performed by the installment plan trustee were as follows:

(1) To authenticate certificates and deliver them to the certificate holder.

(2) To keep books for registration of certificates.

(3) To receive payments from certificate holders, or in some plans, to receive cash or underlying securities from the sponsor.

(4) To make deductions for fees and charges.

(5) To purchase and sell securities as directed in the indenture, or by the sponsor.

(6) To hold all funds and securities received by it in its name as trust property.

(7) To receive dividends, interest, income and profits, and to distribute or reinvest them as directed in the indenture or by the sponsor; to sell all warrants, stock dividends, scrip, and rights for cash and dispose of proceeds in like manner.

(8) To pay taxes assessed against the trust property; to set aside a reserve to cover any contingent tax liability; to contest or determine the validity of any tax assessment.

(9) To deliver the number of trust shares credited to the account of a certificate holder upon withdrawal together with cash for any fractional amount; or to liquidate the account of the certificate holder, and deliver the proceeds to him.

(10) To compute the value of the underlying fund and the proportionate interests of certificate holders (except in plans where the sponsor performs this function).

(11) To keep the accounts of certificate holders and to render information thereof to certificate holders.

(12) To terminate the account of a certificate holder who is in default in accordance with the terms of the indenture, or in some plans, at the request of the sponsor.

(13) To terminate the agreement, liquidate the trust fund and distribute the proceeds if (a) the sponsor winds up or liquidates its affairs, ceases its business, is dissolved, is adjudged bankrupt, is placed in receiverships, or fails or refuses to perform its duties, functions, or obligations; (b) no certificates are outstanding; (c) underlying trust shares are not available; or (d) a successor trustee is not appointed.

(14) To deliver trust property to a successor trustee and to execute all instruments necessary in connection with the transfer.

(15) To perform the duties of the sponsor or to appoint a successor to act in the sponsor's place if the sponsor is unable or unwilling to act under the indenture, or as an alternative to liquidate the trust fund and distribute the assets.

(16) To participate in or assent to any plan or reorganization, readjustment, merger, sale, or consolidation in respect of underlying securities (in some cases subject to the sponsor's approval).

(17) To appear in, prosecute, or defend a judicial proceeding in its discretion, but subject to reimbursement or indemnification against loss or liability.

(18) To agree with the sponsor upon amendments to the indenture or certificates.

The trustee's province normally extended to the nondiscretionary purchase, custodianship, and sale of designated securities and book-keeping entries in connection therewith.²¹⁶ Mr. Simonson testified as follows:²¹⁷

Q. It was purely a mechanical trustee?

A. I should say so.

Q. It was not a trustee in the broader sense of the word of a trustee with discretionary powers?

A. No.

Q. It just held title and acted automatically?

A. In accordance with the terms of their agreement.

Mr. Barton gave his view of this aspect of the indenture:²¹⁸

Q. Under the terms of this agreement as it stands the trustee has very little responsibility.

A. That is correct, absolutely. Practically it is little more than a custodian agreement. They have something more than a custodian generally has to do.

As stated, besides his custodial function, the trustee was required to purchase and sell the underlying securities and to keep the accounts of the certificate holders. In fact, the very nature of the installment investment plan as a method of selling investment trust shares, investment company stock, or participations in a portfolio of common stock, rigidly fixed and determined the function of the trustee as a conduit for the investor's money with the incidental capacities of custodian and bookkeeper or accountant.²¹⁹

²¹⁶ As will be indicated, even for these custodial and accounting duties, elaborate exoneration clauses were set out in the agreement to eliminate liability for ordinary negligence on the part of the trustee. See *infra*.

²¹⁷ Public Examination, Independence Fund of North America, Inc., at 6528.

²¹⁸ Public Examination, Income Foundation, Inc., at 11590.

²¹⁹ In a few cases, the trustee was given some discretionary power as to the elimination or substitution of the underlying security but even in these cases the power was restricted or limited to improbable contingencies.

In the following indenture provision, the discretion accorded was merely as to the manner of elimination of the underlying securities (reply to the Commission's questionnaire for American Participations Certificates, Exhibit A, at 22): "From time to time, the Company, acting in consonance with the opinion of two or more reputable investment counsels, may certify to the Trustee * * * all or any part of any stock then held by the Trustee as Deposited Property should be eliminated then and in that event the Trustee shall use its discretion in the manner of eliminating anyone or more stocks held as Deposited Property as certified by the Company and in the event anyone or more stocks are eliminated the proceeds received therefor shall be invested by the Trustee in Portfolio Units from which the eliminated stock or stocks have been removed. The Trustee shall notify each Beneficiary of such eliminations."

In the following provision, the trustee could substitute underlying securities but only if the designated trust shares were unavailable and if the sponsor failed to exercise its right of substitution, provided that the trust shares selected were "similar in every respect" to the original trust shares and certificate holders consented in writing to the substitution (reply to the Commission's questionnaire for Wellington Foundation Trust Certificates,

The idea of "trusteeship" was, nevertheless, strongly emphasized in the set-up, advertising matter and sales literature of the installment investment plan as well as in the sales talk of dealers and salesmen.²²⁰ Few points of similarity existed between the fiduciary duties and liabilities of the ordinary trustee, familiar to the public, and the non-discretionary duties and limited liabilities of the installment plan trustee,²²¹ yet much was made of such supposed similarity.

2. Prominent Banks and Trust Companies as Trustees

The installment plan trustee was a banking institution or trust company of national prominence or well known in the locality in which certificates were sold.²²² The reputation, size, age, and successful achievements of the bank or trust company were all the subject of careful delineation and exploitation by the sponsor in its sales promotional activities.²²³

The Pennsylvania Company for Insurance on Lives and Granting Annuities, a widely known trust company of Philadelphia, Pennsylvania, acted as trustee for 18 installment investment plans, sponsored by 12 sponsor companies. Next in importance was Empire Trust Company of New York City which acted as trustee for 7 plans sponsored by 4 sponsor companies. Other trustees were located in New York, Pennsylvania, Colorado, Missouri, Michigan, Maryland, California, Illinois, New Jersey, and Delaware.²²⁴ Some trustees resigned

Exhibit A, at 22-3): "In the event of the failure of the Foundation to furnish the Trustee with an adequate source from which the Trustee can purchase on demand at market value, sufficient Trust Shares, or substituted shares—then in the event that the Foundation shall not, previously to the exercise of such right, have given notice of its intention to substitute, the Trustee shall have the right, but shall not be obliged to do so, to select other Trust Shares, similar in every respect to those shares which may be substituted by the Foundation, * * * provided the respective Holders shall give written approval to such substitution * * *."

²²⁰ See Ch. V, Sec. C, *infra*.

²²¹ Cf. the discussion of the nature of the functions of trustee in Ch. V of the Commission's supplemental report on Fixed and Semifixed Investment Trusts. Cf. the following provision from an installment plan indenture (reply to the Commission's questionnaire for Euclid Investment Trust Certificates, Exhibit A, at 11): "The responsibility and liability of the Trust Company to the Investors is that of Custodian only."

²²² See Appendix A for list of trustees and the plans for which they were trustees, together with names of sponsor companies and dates of indentures.

²²³ See Ch. V, Sec. C, *infra*.

²²⁴ The names of these trustees and the number of installment plans for which they acted through December 31, 1937, are as follows:

Name and location of trustee:	Number of plans
Pennsylvania Company for Insurances on Lives and Granting Annuities, Philadelphia, Pa.....	18
Empire Trust Company, New York, N. Y.....	7
Commerce Trust Company, Kansas City, Mo.....	4
Equitable Trust Company, Baltimore, Md.....	4
First National Bank of Jersey City, Jersey City, N. J.....	2
Commercial National Bank & Trust Company, New York, N. Y.....	2
Industrial Trust Company, Wilmington, Del.....	2
Title Insurance & Guaranty Company, San Francisco, Calif.....	2
Trust Company of North America, New York, N. Y.....	1
Continental Bank & Trust Company, New York, N. Y.....	1
City National & Trust Company, Kansas City, Mo.....	1
Central Trust Company, Lansing, Mich.....	1
International Trust Company, Denver, Colo.....	1
Manufacturers Trust Company, New York, N. Y.....	1
City Bank Farmers Trust Company, New York, N. Y.....	1
Colorado National Bank, Denver, Colo.....	1
City National Bank of Philadelphia, Philadelphia, Pa.....	1
Peoples-Pittsburgh Trust Company, Pittsburgh, Pa.....	1
Trust Company of Chicago, Chicago, Ill.....	1
Equitable Trust Company, Detroit, Mich.....	1
Trust Company of New Jersey, Jersey City, N. J.....	1

and were succeeded by other trustees.²²⁵ The major reason for such a change in trustees was the receivership or liquidation of the original trustee. For example, The Harriman National Bank and Trust Company was trustee for six installment investment plans when it failed to reopen in March 1933.²²⁶ Two of these plans failed to obtain the services of a successor trustee and were terminated.²²⁷

3. Qualifications of Successor Trustees

Most installment plan indentures provided for the qualifications of successor trustees as well as the procedure for appointment of a successor. While the sponsor generally reserved the right of appointing a successor, in a few cases a majority of certificate holders could select a successor.²²⁸

The requirements with respect to a successor trustee were usually that it be a banking institution or trust company in the United States of America, operating under state or federal laws, and that it have a minimum capitalization of \$1,000,000 to \$2,000,000.²²⁹

4. Exculpation of Trustee

Without exception, each installment plan indenture examined contained provisions which attempted to exonerate the trustee from one or more of the liabilities ordinarily imposed on a trustee by common law or statute. The exculpatory clauses in the installment plan indenture were designed to absolve the trustee from responsibility for almost every conceivable act, or omission to act, on its part with respect to the installment plan, save for wilful default or gross negligence.²³⁰ In contrast to the emphasis placed in the sales literature upon the standing and reputation of the trustee and the consequent

²²⁵ The following is a list of trustees who resigned or were merged into another institution:

Name of trustee:	Number of plans
Harriman National Bank & Trust Company, New York, N. Y.-----	6
Union Trust Company, Baltimore, Md.-----	3
Guardian Trust Company, Denver, Colo.-----	2
Charleston National Bank, Charleston, W. Va.-----	1
Fidelity Bank & Trust Company, Detroit, Mich.-----	1
Bank of America N. A., New York, N. Y.-----	1
Empire Trust Company, New York, N. Y.-----	1

²²⁶ These installment plans were Trust Endowment Agreements; Future Requirements Plan Investment Certificates FA and FB; Assured Independence Plan Trusteed Certificates; Prudential Assured Estates Trust Certificates; Union Investment Trust Certificates; United Endowment Foundation Endowment Certificates.

²²⁷ These plans were Assured Independence Plan Trusteed Certificates and Prudential Assured Estates Trust Certificates.

²²⁸ The efficacy of a provision giving certificate holders the right to select a successor trustee may be seen in the failure of any certificate holders to present themselves at meetings called by The Harriman National Bank and Trust Company to select a successor when it resigned as trustee (replies to the Commission's questionnaire for Assured Independence Plan Trusteed Certificates and Prudential Assured Estates Trust Certificates).

²²⁹ Derived from an analysis of the replies to the Commission's questionnaire.

²³⁰ For a general discussion of exculpatory provisions see this Commission's Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, Securities and Exchange Commission, Pt. VI, at 67-70.

For discussion of exculpatory provisions concerning trustees of fixed investment trusts, see the Commission's supplemental report on Fixed and Semifixed Investment Trusts, Ch. V.

protection accorded installment plan certificate holders, the trustee declined to assume any perceptible responsibility in connection with the trust. The most usual exculpatory provision was a kind of omnibus exoneration clause which generally exonerated the trustee for all acts or omissions to act not involving gross negligence or wilful default. A typical clause of this kind is as follows:²³¹

The Trustee, save for its own gross negligence or wilful default, shall not be personally liable for any loss or damage. The Trustee shall not be liable for the exercise of any discretion or power hereunder or for mistakes or errors of judgment, nor otherwise, in connection with this trust, except for its own wilful misconduct or gross negligence.

In addition to a blanket exoneration clause the typical installment plan indenture contained provisions for the immunity of the trustee in particular matters. Thus, the indenture commonly contained clauses exculpating the trustee from liability—

(1) for default or misconduct of counsel, agent, attorney in fact, accountant, appraiser, or employee, if selected in good faith or with reasonable care;

(2) for any action taken or omitted in good faith in reliance upon the advice of counsel;

(3) for any action taken or omitted in good faith in reliance upon any resolution, vote, declaration, request, demand, order, notice, waiver, appointment, consent, certificate, affidavit, statement, or market report or upon any other paper or document believed by it to be genuine;

(4) as to the validity, form, sufficiency or enforceability of the underlying securities received by or purchased by it or as to the conformity of these securities with the requirements of the installment plan indenture;

(5) with respect to the validity of any signature believed by it to be genuine or with respect to any action taken thereon;

(6) as to the validity or enforceability of the installment plan agreement or the certificate;

(7) for any delay in the purchase of underlying securities;

(8) as to the performance or observance of any covenants or conditions to be performed by the sponsor;

(9) for assessments, taxes, or other charges against the funds of certificate holders;

(10) for the payment of taxes or for withholding any amount for undetermined tax liability;

(11) for any amendment to the indenture adopted by the trustee and the sponsor;

(12) for the validity, enforceability, or adequacy of any insurance policy;

(13) for any exercise of discretion permitted by the indenture;

(14) for failure to send notices of delinquency to certificate holders;

²³¹ Reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibit A, at 20. Of 34 indentures examined, 31 contained a broad exculpatory clause similar to the one quoted. In some, the "safe-keeping of the trust property" was excepted from the exculpatory clause.

- (15) for the issuance, replacement or assignment of certificates;
- (16) for termination of the account of a certificate holder in default;
- (17) for the appointment of a successor sponsor.

As stated previously, all installment plan indentures contained one or more exculpatory clauses. Practically all installment plan indentures contained most of the exculpatory provisions set forth above.

When examined as to the origin and nature of exoneration provisions in the installment plan indenture, Francis C. Reed, counsel for Independence Fund of North America, Inc., testified that the trustee had insisted upon the inclusion of exculpatory clauses, that he believed that the trustee should be responsible for negligence and "that the trustees themselves have come to that same conclusion."²³²

Mr. Barton conceded that the exoneration clauses in the indenture were unjustifiable and stated his reason for permitting them to be a belief in their inefficacy:²³³

Q. I say, if you assume that the exoneration clauses that are in these trust agreements are enforceable and will protect the Trustee according to their language, then do you think such exoneration clauses are justified?

A. I do not think they are justified if they in any sense relieve the Trustee of the duties that that trust agreement imposed upon him, and if I thought they did I would have kicked very severely at their inclusion, but it is not my understanding that they exonerate the trustee from performing the duties that the trust agreement provides. They merely exonerate the trustee from duties that might be implied.

Not only was the exoneration of the trustee exhaustively set forth but often this was only disclosed in the indenture and not in the sales literature, application forms or certificates which were most likely to be read by the investor. Concerning the nondisclosure of clauses exculpating both the trustee and the sponsor, Mr. Barton testified:²³⁴

Q. Mr. Barton, do you know whether there is any place in this contract where a contract holder can realize the extent of the exculpation clauses in the trust indenture?

A. No.

* * * * *

Q. Again, was the investor given any reason for believing that such clauses would exist in the indenture?

A. Not that I know of.

Q. He wasn't told that when he was sold?

A. Not that I know of, except I think in the contract itself, and in the literature—unless I am greatly mistaken—he was put on notice that the master indenture was available, and he could see it at any time.

Q. Do you know whether anybody ever came in and read the master indenture?

A. Some of them.

Q. How many, do you know?

A. Very few.

²³² Public Examination, Independence Fund of North America, Inc., at 6573-8.

²³³ Public Examination, Income Foundation, Inc., at 11690.

²³⁴ Id., at 11590-1 and 11594.

5. Trustee's Lien on Underlying Securities

In many instances the trustee was given a lien on the underlying property for expenses incurred by it in connection with the administration of the property. In some cases this lien extended to its fees also.

This right granted the trustee was similar to those present in many fixed trust indentures and in other types of trust agreements. In those installment plans under which the sponsor paid the trustee's fees from its own funds, however, the trustee's lien for unpaid fees had particular implications. Under this arrangement, if a sponsor failed to turn over such fees to the trustee after their collection, the trustee had a right to deduct the amount of such fees from the certificate holders' funds in its possession. In view of the unstable nature of many sponsor organizations, such a provision would seem to be a potential source of damage to the certificate holder. Having paid to the sponsor the service fee, in which was included payment for the trustee's services, the certificate holder's fund was liable to be levied on for the same fee.²³⁵

Another type of lien provision is illustrated by the following clause in the indenture for American Participation Agreements:²³⁶

The Company shall pay all reasonable fees, incurred from time to time in the administration of the trust created by this indenture, which are in excess of the maintenance allowance, it being understood and agreed, however, that in the event of the failure of the Company promptly to pay such fees, charges, and expenses (which shall not be limited to the commissions allowed trustees by statute) the Trustee shall have a lien therefor on the amounts payable to the Company for its service fee hereunder and any other funds of the Company deposited with the Trustee in connection with the administration of this Trust.

The indenture under which United Fund Accumulative Certificates, Series TA, were issued provided that "neither the company nor the trustee shall have any lien on deposited securities to cover their compensation other than from prescribed establishment fee and management fee."²³⁷

²³⁵ Mr. Simonson testified (Public Examination, Independence Fund of North America, Inc., at 6535):

Q. Who paid the fees of these trustees and these two different banks?

A. Independence Fund of North America, Inc.

Q. If Independence Fund did not pay them the bank had a lien on the trust estates?

A. Yes.

The following is the pertinent provision from the indenture between Independence Fund of North America and Empire Trust Company for the issuance of Independence Fund Participation Agreements (reply to the Commission's questionnaire for Independence Fund Participation Agreements, Exhibit A, at 26): "The Company covenants and agrees that it will pay all reasonable fees, charges, and expenses of the Trustee * * * it being understood and agreed, however, that in the event of the failure of the Company promptly to pay such fees * * * the Trustee shall have a lien therefor on the deposited Property * * *."

²³⁶ Reply to the Commission's questionnaire for American Participation Agreements, Exhibit A (p. 24).

²³⁷ Reply to the Commission's questionnaire for United Fund Accumulative Certificates, Series TA, Exhibit A (p. 15).

6. Custody and Control of Trust Property by Trustee

Presumably the purpose of the trustee in the installment investment plan was to secure protection for the investor in the handling of all monies paid by certificate holders, the custodianship of underlying securities purchased with these monies, the liquidation of underlying securities and distribution to withdrawing certificate holders, and the keeping of records and accounts in connection with these activities. It was considered that the certificate holders would receive greater protection if these activities were undertaken by an established trust company or banking institution.²³⁸ This was the pronounced purpose for the presence of a trustee in the installment investment plan.²³⁹ Other motives of the sponsor which may be perceived in the emphasis on trusteeship in the sales promotional activities of the sponsor,²⁴⁰ did not prevent the trustee from rendering a real service in the installment investment plan by exercising complete control of the monies and securities of certificate holders at all times.

Under some plans, however, payments were made directly to the sponsor company which deducted fees and charges and delivered the balance of the payments to the trustee for the purchase of the underlying securities or purchased the underlying securities itself and turned them over to the trustee.²⁴¹ Some of these sponsors kept accounts and exercised the function of computing their value. In many plans the trustee received the funds, but the underlying securities were purchased by the sponsor company. In one plan, the trustee did not even have custody of the underlying securities.²⁴²

Aside from the possible direct defalcations of the certificate holders' funds, the dissolution or bankruptcy of the sponsor might involve loss to the investor whether the sponsor receives the payments or funds of certificate holders or retains the purchased securities. Concerning this subject, Mr. Thomas testified:²⁴³

A. Well, the change from the payments being made to a sponsor company, to a trustee, eliminated the possibility of a sponsor becoming financially insolvent, and the investors sustaining a loss through such a thing. It resulted in the listing of the fiduciary relationship from a custodianship to a trusteeship, which was an additional safeguard to the investor. The original set-up of the thing didn't provide any protection for the investor if something happened to the sponsor at all. The trustee could withdraw and walk away, and that was the end of it. The present indenture provides that the trustees guarantee to carry

²³⁸ Public Examination, Independence Fund of North America, Inc., at 6584.

²³⁹ Public Examination, Financial Independence Founders, Inc., at 6373-5.

²⁴⁰ See Ch. V, Sec. C, *infra*.

²⁴¹ Replies to the Commission's questionnaire for United Fund Accumulative Certificates, Series TA; North American Bond and Share Bond and Participating Certificates; Insured Investors Series A Certificates; Corporate Leaders Trust Certificates; Investors Independence Trust Share Certificates; Hamilton Trust Shares Certificates; Independence Fund Participation Agreements; Thrift Investment Certificates of Agreement, Item 19a.

²⁴² Reply to the Commission's questionnaire for Income Foundation Fund Agreements and Certificates of Trust, Items 9 and 13. In this plan, the trustee merely holds shares of the underlying management company stock of Income Foundation Fund, Inc., which is also the sponsor of the installment plan. The underlying portfolio securities are not held by any trustee. The sponsor has voluntarily arranged for custodianship of these securities, but they are subject to the sponsor's order. (*Id.*, Exhibit K, at 17)

²⁴³ Public Examination, Financial Independence Founders, Inc., at 6390-2.

the plan to completion, and to invest the money in accordance with the indenture, if the investor keeps up his payments.

Q. You consider that those trustee arrangements are vital improvements?

A. I consider that they have all made a sounder program from the standpoint of the founder [certificate holder].

* * * * *

Q. And, as a matter of fact, taking your specific case, you, as a company for a while, weren't making much money, were you?

You were operating at a loss over a period of time, and the founder might possibly have become involved in your financial difficulties if you had gotten into financial difficulties? Isn't that so? From which you protected him by putting it in with the trustee?

A. That is correct.

The following testimony of Mr. Simonson clearly illustrates the danger of loss for investors in a situation in which the sponsor had possession of the certificate holders' funds:²⁴⁴

Q. So that in 1934 the sponsor was in quite financial straits.

A. That is right.

Q. And that is the time when it had been receiving money from the founders, and if the creditors had attached its assets, it might have been difficult for the founders, and that is why the direct payments to the trustee were so important?

A. I feel that way.²⁴⁵

7. Resignation or Removal of the Trustee

While most indentures provide that the trustee might resign as to all certificates issued subsequent to the effective date of resignation,²⁴⁶ many indentures provide that the trustee might resign as to all certificates, those outstanding as well as those issued subsequently.²⁴⁷ In the event that the trustee resigned as to all outstanding certificates under the terms of indentures containing the latter provision, provision was made for the appointment of a successor trustee. The possibility existed, nevertheless, that a successor trustee might not be found. In this event liquidation of the certificate holders' fund and distribution of the proceeds would take place. In two instances this has occurred.²⁴⁸

A premature distribution of the certificate holders' fund would probably result in many losses, particularly to those certificate holders who had only made the early payments on the certificates, from which the sales load was taken. In addition, the investors would lose the services and the program of investment for which they had already

²⁴⁴ Public Examination, Independence Fund of North America, Inc., at 6400.

²⁴⁵ A pertinent point to be considered in this connection is the desirability of the segregation of the plan's funds from the other assets of the trustee. Insolvency or failure of the trustee will then not affect the certificate holders' property. When The Harriman National Bank and Trust Company closed in 1933 it was acting as trustee for six installment plans. No loss to certificate holders occurred, however, by reason of the bank's liabilities to others (reply to the Commission's questionnaire for Prudential Assured Estates Trust Certificates).

²⁴⁶ 31 indentures contained provisions permitting the resignation of the trustee.

²⁴⁷ 21 indentures provided that a trustee might resign as to all certificates outstanding.

²⁴⁸ Replies to the Commission's questionnaire for Prudential Assured Estates Trust Certificates and Assured Independence Plan Trustee Certificates.

paid. Moreover, liquidation at a time when the market value of the underlying securities was low might result in more serious loss to the certificate holders.

Most plans provided that the sponsor might remove the trustee in its discretion. A typical provision of this type is the following:²⁴⁹

On written notice served upon the Trustee, the Company may remove the Trustee and/or any successor Trustee and the Trustee so removed shall have no obligations hereunder with respect to Contract Certificates issued after the effective date of such removal. The removal of the Trustee shall take effect on the day specified in the notice thereof, which day shall not be less than sixty days from the date of such service, unless previous to the date so fixed in any such notice a successor trustee shall have been appointed and shall have accepted such appointment in the manner hereinbefore provided, in which event such removal shall take effect immediately upon the appointment and acceptance by such successor trustee. Upon the removal of the Trustee the Company shall appoint a successor trustee and shall advertise such removal and appointment in the manner provided in Section 1 of this Article V.

Removal of the trustee and failure to appoint a successor trustee would result in involuntary liquidation of the certificate holders' funds. In some cases, removal of the trustee was specifically conditioned upon the obtaining of the consent of a successor trustee to act as trustee in the plan.

E. THE INSTALLMENT PLAN INDENTURE

The installment plan indenture generally set forth in great detail all the rights and obligations of the trustee, the sponsor company, and the certificate holder. In some cases, the installment plan certificate supplemented the indenture by setting forth terms and conditions not contained in the indenture,²⁵⁰ thus rendering the complicated, prolix, and highly technical agreement even more difficult of understanding by the investor, particularly the investor for whom the installment plan was designed.²⁵¹ Several of the later indentures have made considerable progress in simplifying language and terms.²⁵²

Generally, counsel for the sponsor drafted the installment plan agreement and submitted it to the trustee for approval. Certificate holders, of course, had no voice or representation in the preparation of the instrument but became parties to the agreement automatically by accepting a certificate.

The trust agreement for the installment investment plan was originally adapted from the fixed investment trust agreements and the

²⁴⁹ Reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Exhibit A, at 17.

²⁵⁰ Reply to the Commission's questionnaire for Financial Independence Founders Trust Certificates, Exhibit A.

²⁵¹ In some instances the indenture and the certificate were contained in the same document issued to certificate holders. All the terms of the plan were contained in this instrument. See the replies to the Commission's questionnaire for Trust Endowment Agreements, Standard Trust Foundation Agreements, and Independence Fund Declarations of Trust and Agreements, Exhibit A.

²⁵² Replies to the Commission's questionnaire for Income Foundation Fund Agreements and Certificates of Trust and Independence Fund Declarations of Trust and Agreements, Exhibit A.

corporate mortgage indentures.²⁵³ Many provisions, notably the exculpatory clauses, were carried over intact and made part of the new indenture.²⁵⁴ Other provisions were necessarily original, consonant with the scheme of the installment plan. The early sponsors of the installment plan had no previous experience with this investment medium and had no guide in creating their trust agreements.²⁵⁵ These sponsors soon made changes in the early trust agreements or promoted new plans under new agreements which meant an increase in their profits or an enhancement of the sales appeal of their plans.²⁵⁶

1. Rights of Certificate Holders

Since legal title to the funds and property of certificate holders was vested in the trustee, certificate holders occupied the position of equitable owners or beneficiaries of a trust. In fact, this relationship of certificate holders in the plan was frequently expressly set out in the indenture. A typical provision covering this point is as follows:²⁵⁷

It is expressly understood and agreed by each of the parties hereto that it is their intention to create the relationship of Trustee and *cestui que trust* between the Trustee and each Beneficiary [certificate holder], and that such Beneficiaries hold no other relationship to the Trustee but that of grantors of express revocable trusts in respect of the property noted in the account of each such Beneficiary, and such Beneficiaries have only those rights conferred on them under this Trust Agreement as such *cestuis que trustent* hereunder and nothing contained in this Trust Agreement or the Certificates shall be so construed as to constitute the Beneficiaries partners or members of an association.

Several indentures contain a clause similar to the following one purporting to exonerate the certificate holders from any obligations except as set forth in the agreement.²⁵⁸

The registered holders of Certificates shall in no event incur any liability or obligation hereunder except as expressly provided for herein, and all persons dealing with the Trustee shall, as regards the liability of such registered holders, of the Company and of the Trustee, look only to the Deposited Property for satisfaction of claims of any sort.

²⁵³ Public Examination, Independence Fund of North America, Inc., at 6573.

²⁵⁴ Id., at 6530-1 and 6573. See also Public Examination, Transcontinent Shares Corporation, at 13905.

²⁵⁵ Public Examination, Independence Fund of North America, Inc., at 6573.

²⁵⁶ Id., at 6583-5; and Public Examination, Financial Independence Founders, Inc., at 6250. The activities of the sponsor companies in "switching" certificate holders from one installment investment plan to a new one created under an amended indenture or under a new indenture, appears to have been incidental to the activities of the sponsor in creating new plans with different terms. Abuses in connection with these activities, with concomitant profit to the sponsor and unnecessary expense to the investor, have been discussed in a foregoing section. See Ch. IV, Sec. A, 5, supra.

²⁵⁷ Reply to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Exhibit A, at 76. It may be noted that this provision also provides that certificate holders are not to be considered partners or members of an association. This provision was generally set forth in indentures, apparently, for tax-avoidance reasons.

²⁵⁸ Reply to the Commission's questionnaire for Independence Fund Participation Agreements, Exhibit A, at 28. See also the replies to the Commission's questionnaire for National Unit Cumulative Investment Certificates (Exhibit A, at 10); American Participation Certificates (Exhibit A, at 32), North American Bond and Share Bond and Participating Certificates (Exhibit A, at 37), and United Fund Accumulative Certificates, Series TA (Exhibit A, at 11).

The value of this provision to certificate holders and its effect as to strangers to the indenture is extremely conjectural.

2. Voting Rights

Many indentures contained some provision concerning the exercise of voting rights with respect to the underlying securities. Generally, the sponsor reserved the right to vote and could require the trustee to deliver to it proxies or powers of attorney to vote the shares of underlying securities or could require the trustee to vote the shares at the direction of the sponsor. In many of these cases, certificate holders were entitled to the privilege of voting instead of the sponsor, if they requested the right. However, the right of certificate holders to vote was generally subject to restrictions. Thus, the indenture covering United Endowment Foundation Endowment Certificates contains the following provision:²⁵⁹

* * * Nevertheless, but only in any case where the Foundation [sponsor], in its absolute discretion, decides that the uniformity of the property underlying such Trust Shares will not be affected, any Beneficiary [certificate holder] shall be entitled, upon written request to the Foundation within five (5) days before the date fixed for any stockholders meeting, to demand the right to vote with respect to said underlying shares, but only if one thousand (1,000) Trust Shares or multiples thereof issued under any one Indenture are noted in his account, and then only to the extent provided by the terms and provisions of such Indenture, and thereupon, the Foundation shall execute and deliver to such Beneficiary or Beneficiaries sufficient proxies or powers of attorney to enable them so to vote.

Few certificate holders exercised their voting rights.²⁶⁰ The effect of the voting power which the installment plan sponsor could exercise on the management or elections of officers and directors of the underlying companies was probably small in view of the large size of the corporations whose stocks underlay the plans. In some instances, however, voting rights were extremely important to certificate holders and the use of the privilege affected the substantive rights of certificate holders.

Wellington Foundation, Inc., sponsor of Wellington Foundation Trust Certificates, utilized shares of capital stock of Wellington Fund, Inc., a management investment company with open-end provisions, as underlying security for the installment plan. The contract between the sponsor and Wellington Fund, Inc., covering the purchase of the management company's stock for installment plan certificate holders, contained a provision to the effect that if the certificate holders failed to exercise their right to vote the shares of Wellington Fund, Inc. stock held for them by the trustee, proxies

²⁵⁹ Reply to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Exhibit A, at 52. Another example is the provision for voting rights of certificate holders in the indenture under which American Participations Certificates were issued. In this case, a certificate holder was required to have a complete portfolio unit to his credit to enable him to vote. This meant ownership of 33 high-priced common stocks (reply to the Commission's questionnaire for American Participations Certificates, Exhibit A, at 31).

²⁶⁰ Public Examination, Income Foundation, Inc., at 11675.

to vote these shares would be given by the trustee equally to the sponsor and two named directors of Wellington Fund, Inc.²⁶¹

Wellington Fund, Inc. entered into a management contract with The Wellington Corporation, an investment counsel firm, on July 19, 1933. Concerning the compensation payable to the investment counsel firm under this contract, the securities registration statement of Wellington Fund, Inc. contained the following:

Compensation payable to The Wellington Corporation is based on accomplishment as reflected by realized regular earnings, security profits, and unrealized appreciation in value of securities. No fee can be paid for management supervision unless and until shareholders earn 6% on the value of their shares as shown below. Then, by a division of realized profits and/or appreciation after the 6% return, a percentage of such excess accrues to shareholders and the balance is payable to Wellington Corporation. The percentage varies from 25% when the Fund has resources of \$500,000, to 15% when resources exceed \$1,500,000. Inasmuch as the market value of the Fund on June 30, 1937, exceeded \$1,500,000, the 15 percentage of profits and/or appreciation accrues to the management, and the balance, or 85%, accrues to shareholders.

In March 1938 an amendment to this contract was proposed by directors under which compensation to the investment counsel firm was changed from a decreasing percentage of the excess of earnings, profits, and unrealized appreciation over 6%, to a fixed percentage based upon the average net assets of Wellington Fund, Inc., to wit, $\frac{1}{4}$ of 1% to be paid quarterly on the first \$4,000,000 of average net assets and $\frac{1}{8}$ of 1% quarterly on the excess of \$4,000,000. This proposal was submitted to stockholders of Wellington Fund, Inc., on March 18, 1938, and was ratified by them.²⁶²

At the date that the amendment was approved, the market value of shares of Wellington Fund, Inc., was \$12.02. Under the original agreement The Wellington Corporation was obligated to furnish its services without additional compensation until the market value of shares increased to \$20.97, which was the value on the date when the previous management fee was paid.²⁶³ Hence, by the amendment, the investment counsel firm was given a fixed fee during a period in which no fee would otherwise have been due and for which payment had already been received. The Wellington Corporation exchanged its rights to possible future fees contingent upon what was previously termed "accomplishment as reflected by realized regular earnings, security profits, and unrealized appreciation" and received a fixed percentage. From 1929 to 1937 compensation to The Wellington Corporation averaged approximately \$20,000 and no fees were paid after March 31, 1937, under the original contract.²⁶⁴ After the amendment to the contract was agreed upon, the annual compensation to that firm, based upon net assets at December 31, 1938, was estimated at approximately \$42,000.²⁶⁵

²⁶¹ Securities Registration Statement for Wellington Fund, Inc., File No. 2-3146, filed with the Securities and Exchange Commission September 17, 1937, Item 46. The directors named were Walter L. Morgan and Charles L. Ludington.

²⁶² Id., Amendment filed March 24, 1938, Item 46.

²⁶³ Id., Amendment filed May 11, 1938, Item 46.

²⁶⁴ Ibid.

²⁶⁵ Id., Prospectus filed April 19, 1939, at 8.

While no inference as to the merit of the amendment is sought to be made here, it is clear that the exercise of voting rights in this case was important to holders of Wellington Foundation Trust Certificates as beneficial owners of Wellington Fund, Inc., capital stock. No information is available as to the number of certificate holders who actually requested the trustee for proxies to vote. The failure of certificate holders to vote, however, bestowed the voting privilege on the sponsor and on two directors of Wellington Fund, Inc.²⁶⁶

Income Foundation Fund, Inc., an open-end management company, also extended voting rights to certificate holders. In this case the issuer of capital stock of a management company was also the sponsor of installment plan certificates.²⁶⁷ Technically, the company was controlled by a board of directors elected by owners of shares of the capital stock of the company. Actually, these directors were chosen by Income Foundation, Inc., distributor of the installment plan certificates. When examined on the extent of voting by certificate holders, Mr. Barton testified:²⁶⁸

Q. In relation to the voting by the certificate holders, how many certificate holders at your last annual meeting requested a proxy?

A. I think one.

Q. How many attended the meeting in person?

A. None.

Thus, in actuality, Income Foundation, Inc. exercised complete control of Income Foundation Fund, Inc.²⁶⁹

3. Amendment of the Installment Plan Indenture

Practically all installment investment plan indentures contained a provision covering the amendment of the instrument.²⁷⁰ Under these amendment provisions the certificate holders were rarely given the

²⁶⁶ No information is available as to the number of shares held by certificate holders on March 18, 1938, but some idea of the proportion held by them may be obtained by the fact that on September 30, 1937, certificate holders owned 72,235 shares of Wellington Fund, Inc. capital stock out of 219,882 shares outstanding, and on October 31, 1938, they held approximately 122,000 shares out of approximately 300,000 shares outstanding (Securities Registration Statement of Wellington Foundation, Inc., File No. 2-3381, filed with the Securities and Exchange Commission August 30, 1937, Prospectus filed August 31, 1938, at 32 and 82; Prospectus filed December 23, 1938, at 30 and 45; and Prospectus filed May 1, 1939, at 74).

²⁶⁷ The distributor of installment plan certificates, however, was Income Foundation, Inc. (reply to the Commission's questionnaire for Income Foundation Fund Agreements and Certificates of Trust, Exhibit K).

²⁶⁸ Public Examination, Income Foundation, Inc., at 11675.

²⁶⁹ It was asserted that the trustee would attempt to assure proper management of the fund by refusing to act as trustee for future certificate holders or by requesting certificate holders to vote for a new management proposed by the trustee. The reluctance of a trustee actively to interfere in the management of a company, however, may be seen in the following testimony of Mr. Barton (id., at 11674):

A. * * * The next point; we knew by experience that few, if any, would ask for a proxy. How were we going to get a quorum? We urged the trustees to vote those shares. They refused to do so. They said, "If we do so, we will be deemed to be managing the Fund, probably, by the courts."

Somebody had to get those proxies to get a quorum. The only institution or individual that we could think of that would function that way, that had any real interest in the Fund at heart, was Income Foundation, Inc., so that the trust provision provides that if the trust holders do not request proxies the proxies must be turned over to Income Foundation, Inc.

²⁷⁰ Of 34 indentures examined, 31 contained some provision for amendment.

opportunity to accept or reject the proposed alteration of the terms of their agreement.²⁷¹ Generally the provision governing amendments permitted the trustee and the sponsor company jointly to agree upon an alteration or change in any of the terms of the indenture without the consent of certificate holders, with the limitation that the amendment was not to impair or adversely affect the substantial rights of certificate holders.²⁷²

While most of these provisions by their terms were not to affect the substantial rights of certificate holders, the power given to the trustee and the sponsor to alter the rights of certificate holders created a degree of uncertainty concerning these rights of which certificate holders might well complain. The existence of this power subjected the terms and conditions of the indenture to a change which might possibly work to his detriment. This type of provision placed upon certificate holders the burden of determining whether such detriment existed. Certificate holders would not only have to discover such changes in the terms and conditions of their agreement and their disadvantages, but also would have the burden after such discovery of litigating the questions involved. Such litigation would not only be expensive but hazardous in view of the difficulty of defining "substantial rights." Unlike the situation with respect to investors in other types of securities such as the holders of fixed trust shares, the sponsor or trustee would experience no difficulty in reaching each holder of an installment plan certificate with respect to a proposed change in the terms of the agreement.

4. Unclaimed Funds

Under most installment investment plans funds of certificate holders which were unclaimed would escheat to the state having jurisdiction over the funds of such certificate holders.²⁷³ Several plans, however, provided that any unclaimed funds were to be turned over to the sponsor company after a designated period of time.²⁷⁴ In the event that a certificate holder at some future date seeks to obtain the money that had been turned over to a sponsor company under the terms of an indenture permitting this procedure, he might be confronted with a situation in which the sponsor company would be unable to pay or was no longer in existence.

²⁷¹ Three indentures provided that a majority of certificate holders might reject a proposed amendment by affirmatively expressing their disapproval. Four indentures provided that the consent of a majority of certificate holders was required to make effective a proposed amendment. In these instances the indentures provided that substantive changes in the indenture might be made.

²⁷² Twenty-one indentures contained a provision substantially of this type. Three indentures provided that an amendment was not to affect the rights of holders of certificates issued prior to the effective date of the amendment.

²⁷³ Twenty-three sponsor companies of 34 which answered this question stated that unclaimed funds would escheat to the state under the laws of which the fund of certificate holders were held.

²⁷⁴ Seven installment plan indentures provided that unclaimed funds were to be turned over to the sponsor company. In the case of United Endowment Foundation Endowment Certificates which contained provisions governing unclaimed funds, the amount of such funds as of December 31, 1935, was \$1,058.62 (reply to the Commission's questionnaire for United Endowment Foundation Endowment Certificates, Item 19 (e)).

5. Termination of the Installment Investment Plan

In a majority of cases no limitation of time or time of expiration was specified for the installment plan indenture.²⁷⁵ Termination of the indenture and liquidation of the property held by the trustee was generally provided for, however, under various circumstances. Usually the trustee was given the right to terminate the indenture, liquidate the fund of certificate holders, and distribute the proceeds if the sponsor either wound up or liquidated its affairs, ceased business, was dissolved, was adjudged bankrupt, or failed or refused to perform its duties, functions, or obligations. Termination by the trustee was required in many plans either when no underlying trust shares were available, when no certificates were outstanding, or when no successor trustee was appointed if the trustee should resign, be removed, or be unable to perform its duties. Several plans provided for termination in the event that the operation of the installment plan was hindered by law.

In two instances plans were terminated by reason of the resignation of the trustee and the failure to appoint a successor trustee.²⁷⁶ In another case the receivership of the sponsor caused the termination of the plan.²⁷⁷ The reasons for the termination of other plans are not a matter of record.

²⁷⁵ Ten installment plan indentures had definite dates of termination ranging from 30 to 50 years after the date of the signing of the agreement.

²⁷⁶ Replies to the Commission's questionnaire for Prudential Assured Estates Trust Certificates and Assured Independence Plan Trusteed Certificates.

²⁷⁷ Reply to the Commission's questionnaire for Accumulating Investment Plan Subscription Certificates.

Chapter V

PROBLEMS AND DEFECTS IN CONNECTION WITH THE DISTRIBUTION OF INSTALLMENT INVESTMENT PLAN CERTIFICATES

A. SALES ORGANIZATION

The problems and defects of the installment investment plans are inextricably related with the method of distributing their certificates. The type of sales organization developed by the installment plan sponsor was an important factor in the development of abuses in the industry.

Installment plan certificates were first widely distributed by independent security dealers. Sales organizations formed by the sponsor companies, directly or by means of affiliated companies, gradually displaced these security dealers.¹ After 1933, the volume of sales by independent security dealers decreased.²

With the increase in the sales staffs of the sponsor companies, a complex organization of sales personnel was created,³ branch offices were opened, and vigorous methods of sales stimulation were instituted, including all the devices practiced by large merchandise organizations, such as sales contests for prizes, periodic messages to salesmen, dinners, and "pep talks."

According to questionnaire replies, up to December 31, 1935, 22 of the principal sponsors employed a total of 1,994 employees, including salesmen, of whom 312 were on a salary basis and 1,682 were on a commission basis. As at December 31, 1935, 11 sponsors operated 50 branch offices and employed 361 persons in cities throughout the country.

After 1935, the number of salesmen employed by sponsor companies increased greatly. No figures are available but a specific case will illustrate this fact. Thus, Capital Savings Plan, Inc., with 249 salesmen at the end of 1935, was employing 500 in June 1938.⁴

¹ Public Examination, Financial Independence Founders, Inc., at 6348.

² See Table 1, *supra*.

³ For example, Hamilton Depositors Corporation had a sales manager, a state manager, and a district manager besides the salesmen (reply to Commission's questionnaire for Hamilton Trust Share Certificates, Item 17); and Benjamin Franklin Foundation, Inc., had a field manager, an associate manager, a manager and a regional director (*Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc., et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavit of William S. Becker, Exhibit A).

⁴ Reply to the Commission's questionnaire for Capital Savings Plan Contract Certificates, Item 17, and hearing *In the Matter of Capital Savings Plan, Inc.*, held on June 2, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 81.

This company alone had employed 1,280 salesmen since its formation.⁵

With the creation of a large sales organization, sales expenses mounted. The overhead expenses of branch offices, including remuneration to sales managers and branch managers, increased selling costs. These expenses and the remuneration of managers and salesmen were solely dependent on the sale of installment plan certificates. The sales aspect of the installment plan predominated in every function of the sponsor organization. The following testimony of Mr. Geary illustrates this point:⁶

Q. Capital Savings Plan, Inc., was purely a selling organization?

A. Well, it is also a party to the contract of the investor.

Q. Primarily, it is a sales organization?

A. Yes.

Q. And practically all of its income is derived from selling Capital Savings Plan Contract Certificates?

A. Yes.

Q. Since it is a selling organization, the expenses would pertain to the selling end?

A. That is right.

Q. And your capital structure is peculiarly suited to a selling organization—single issue of common stock, no funded debt, no investments, no reserves, etc.? etc.?

A. Right.

Q. And your employees are primarily salesmen and agency managers?

A. Yes.

Q. Employed on a commission basis?

A. Yes.

Rowland A. Robbins, vice president of Financial Independence Founders, Inc., testified to the same effect:⁷

Q. First let me ask, is Financial Independence Founders primarily a selling organization?

A. Entirely so.

Q. Entirely a selling organization?

A. Yes, nothing more than a sales organization.

Sales managers, branch managers, and salesmen derived their compensation from the primary sales load or "service fee" deducted by the sponsor from the certificate holder's payments. This allocation of the service fee is typified by the following participation in the

⁵ Ibid.

⁶ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on May 24, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 42-44.

⁷ Hearings *In the Matter of Financial Independence Founders, Inc.*, held on May 31, 1938, pursuant to order for investigation dated April 19, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 28.

service fee of \$60 deducted from a \$1,200 certificate of Independence Fund Trust Certificates:⁸

Salesmen -----	\$24 maximum.
Branch manager -----	11.
Sales manager -----	5.
Sponsor -----	20.
Total -----	⁹ 60

Most sponsors paid about \$25 in commissions to their salesmen.¹⁰ The average commission for 29 plans was \$29.65. This commission was generally obtained by the salesmen in the first few months of the plan.¹¹ The average period in which the commission was obtained for 29 plans was 13½ months.

⁸ Reply to the Commission's questionnaire for Independence Fund Trust Certificates, Item 17.

⁹ Mr. Robbins explained the procedure in his company in splitting the service fee similarly (op. cit. supra, note 7, at 33-4):

Q. What is your basic compensation?

A. \$25 to an ordinary representative, and the average representative. And that man, after he has been with the company a certain period of time, if we decide that he warrants being made a rate of \$30 a unit, why, then, that rate is increased.

Q. To \$30?

A. To \$30, that is correct.

Q. Is that tops?

A. For salesmen; yes.

Q. Now, these men in charge of your branch offices, you say if you paid the rent and they pay the telephone, they get an override of \$5, is that right?

A. That is right. They also have the continuing commissions, the same with renewals in life insurance.

Q. If this man in charge of your branch office pays for everything, he gets an override of \$10?

A. If he pays for everything, he gets an override of \$10?

Q. Yes.

A. I wouldn't say that. The salesmen that he employs get the same base rate we pay here in New York, which is \$25.

Q. He may get an override of \$15?

A. That is correct, he may.

Q. But he will always get at least \$10 override on sales made by salesmen?

A. That is correct.

¹⁰ The amount of salesmen's commissions paid in 29 different plans was as follows:

<i>Amount of commissions</i>	<i>Number of plans</i>
\$20 -----	1
\$23 -----	1
\$24 -----	4
\$25 -----	11
\$30 -----	3
\$35 -----	1
\$36 -----	3
\$38 -----	1
\$40 -----	2
\$44 -----	1
\$51 -----	1

¹¹ The duration of the period in which salesmen's commissions were deducted varied for 29 different plans:

<i>Period in which salesmen's commissions were deducted (months from initial fee)</i>	<i>Number of plans</i>
1 -----	1
6 -----	13
10 -----	7
12 -----	2
18 -----	2
38 -----	2
48 -----	1
60 -----	1

It is interesting to note that in spite of the high selling fees paid by installment plan investors, the remuneration of individual salesmen was small. The following testimony of Mr. Young concerning a reorganization of the sales force of Income Estates of America, Inc., is pertinent as to the earnings of salesmen:¹²

A. * * * We then made it compulsory for every man to be active who was to be in the business. If he had not written any business within the last two months' period he was dropped. We made a thorough study of all the men we had in the organization, and any we didn't think were capable of making a living were dropped, and that is the reason why our sales have gone to practically nothing.

It is interesting to note that in 1935, when a total of approximately 1,700 salesmen were employed by sponsor companies, the number of certificates sold in dollar amount payable during the year, excluding sales by security dealers, was less than \$24,000,000, or an average of about \$14,000 in amount payable sold by each salesman. The annual average compensation to salesmen, therefore, based on the average of \$30 for a \$1,200 basic unit, was less than \$360 per annum.

Also pertinent to the matter of salesmen's earnings is the following testimony of Mr. Schryer concerning the salesman's sphere for securing customers:¹³

Q. When you did attempt to make a sale what is your method of securing prospects?

A. Any time I have attempted to sell I have tried to sell to people I know, to friends.

Q. What is the usual method used by your salesmen?

A. I don't know; I imagine a lot of them sell friends or relatives, or acquaintances and some of them of course cold canvass.

Q. Eventually they will run out of friends and relatives?

A. Sure; then they are on the cold canvass end of it. That's pretty tough.

In case of *Deckert v. Independence Shares Corporation*,¹⁴ the court came to the same conclusion. The court stated:

Taken as a whole, the testimony and exhibits offered in evidence disclosed, in summary:

* * * * *

(4) That the Independence Shares Corporation, and its predecessor, employed salesmen from every walk of life without necessary and proper qualifications, and solely because of the fact that they were in a position to sell fellow employees, relatives, friends, neighbors, and persons with whom they enjoyed business relations.

¹² Hearings *In the Matter of Income Estates of America, Inc.*, held on June 29, 1938, pursuant to order for investigation, dated April 19, 1938, under Sec. 19 (e) and Sec. 20 (a) of the Securities Act of 1933, at 13.

¹³ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 23.

¹⁴ *Robert J. Deckert et al. v. Independence Shares Corporation et al.*, United States District Court for the Eastern District of Pennsylvania, Civil Action No. 218 (1939), at 12. This case is discussed more fully infra.

The commissions paid to independent security dealers were higher than those paid to salesmen.¹⁵ Dealers' commissions ranged from \$28 to \$73 in 19 plans. The period of time in which these commissions were obtained was similar to that for salesmen.¹⁶

The turnover of salesmen, as might be expected, was high. Mr. Young estimated it at 25%.¹⁷ Mr. Geary testified that he employed 500 salesmen in June 1938, as compared with a total of 1,280 throughout the period of existence of the company.¹⁸ Mr. Thomas, however, testified that the number of salesmen who left the employ of the sponsor was not large, after a change in policy in hiring men. Mr. Thomas testified:¹⁹

A. We had a very large turnover, when we advertised for men. We would engage a group of men, maybe 30 at a clip, after having put them through a training school.

Q. How long did that training take?

A. Four or five days. And we would sign them up to go to work and turn them over to a crew manager, five men to a manager, during that period, and we lost about 80 per cent of those fellows. But we realized that wasn't getting us anywhere, so we abandoned that method entirely.

* * * * *

Q. But don't you find there is a continual turnover of salesmen who are able to sell to their friends and family, and don't go any farther, and you have to get rid of them?

A. No; I would say not. Not under the present operation. That perhaps used to be the case.

Q. That used to be the way it was?

A. Perhaps, on account of that method of recruiting the men, that might have been like that.

Q. Because of that method of recruiting the men, and that method of recruiting men you feel is not a satisfactory one, as the result of your experience?

A. I would say that it was not.

¹⁵ Dealers' commissions varied as follows in 19 different plans:

<i>Amount of commission (minimum)</i>	<i>Number of plans</i>
\$28-----	1
\$30-----	1
\$34-----	2
\$36-----	1
\$38-----	1
\$40-----	7
\$45-----	1
\$48-----	1
\$50-----	3
\$73-----	1

¹⁶ This period of time was as follows for the 19 plans:

<i>Period in which dealers' commissions were obtained (months from initial fee)</i>	<i>Number of plans</i>
1-----	1
6-----	5
10-----	6
12-----	3
18-----	2
48-----	1
60-----	1

¹⁷ Op. cit. supra, note 12, at 12.

¹⁸ Op. cit. supra, note 4.

¹⁹ Public Examination, Financial Independence Founders, Inc., at 6409 and 6411-12.

The method of obtaining salesmen was thus considered important in securing proper sales practices.²⁰ Nevertheless, proper training and constant supervision were patently equally important. Lack of understanding would naturally result in an inaccurate and misleading presentation of the plan to the prospect.

A newspaper advertisement for salesmen, submitted as representative by one sponsor, Independence Fund of North America, Inc., read as follows:²¹

Opening of the new business department of downtown financial institution specializing in personal trust accounts creates opportunity for intelligent, educated men of good character and selling ability; liberal commission and effective cooperation.

Mr. Simonson testified with respect to this advertisement:²²

Q. They were used to get your salesmen, were they not?

A. About 15 percent of them; yes.

Q. And some of them as late as August of this year.

A. Yes. About 15 percent of our salesmen are obtained through newspaper advertisements. That is the statement on that.

Sound training for salesmen as well as the securing of proper salesmen was obviously an important protection against improper sales practices. In view of the extent of the complaints of certificate holders and the testimony and affidavits of salesmen, it is debatable whether sponsors gave their salesmen courses of instruction in the structure and operation of the installment investment plan or in methods of breaking down sales resistance. While training in selling may not be subject to censure in and of itself, a practice that emphasized knowledge of sales technique at the expense of knowledge of the commodity to be sold must be severely criticized.

The statements of two salesmen, as related in their sworn affidavits filed in one of the Commission's injunction proceedings,²³ supports the conclusions: that salesmen were sent out without adequate training;²⁴ that salesmen were given "canned sales talks" containing misleading statements;²⁵ that salesmen were coached to minimize fees and to omit any reference to the "trust-on-a-trust" nature of the installment plan;²⁶ that salesmen were instructed to draw

²⁰ The importance of obtaining properly qualified salesmen is illustrated by the opinion of one officer of an installment plan sponsor company to the effect that "frequently the type of salesmen employed in selling plans of this kind may be of a type where you are not apt to get a fair presentation by the average man who goes around and sells a \$10 plan (Public Examination, Transcontinent Shares Corporation, at 13910-11).

²¹ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 611.

²² *Id.*, at 6673-5.

²³ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc., et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavits of John C. Larkin, Wm. S. Becker, sworn to January 19, 1938, and January 3, 1938, respectively.

²⁴ See also *id.*, Exhibit No. 111.

²⁵ The "sales presentation talk" memorized by one salesman is set forth in Appendix C.

²⁶ Compare the following instruction alleged to have been sent out to a salesman disclosing the manner in which certificate holders were induced to purchase certificates (*op. cit.* supra, note 23, Exhibit No. 113): "It is perfectly proper that you should digest everything interesting to this business but do not go into too much detail with a client. After all is said and done is: (1) Do you want to Rent your Money? (2) Do you want a

charts that depicted the installment plan with assured appreciation of principal and definite yield of income, and charts that compared the installment plan with a savings account, a building and loan account and an insurance endowment policy; and that salesmen represented the plan as surpassing the other forms of investment in all respects without revealing the amount of deductions which first would have to be made up by appreciation or earnings in order to place the investor in his original position, and without pointing out the indeterminate nature of earnings and the likelihood of depreciation as well as appreciation of the underlying securities.

These salesmen also asserted that they were told to stress the matter of "trusteeship" and the "trustee," to assure purchasers of a maturity value of \$2,000 or more in 10 years on a \$1,200 unit, to avoid mention of the deduction of the service fee in the early period of the plan's duration and to assure purchasers of the liquidity and availability for withdrawal of their payments at any time.²⁷

The court's opinion in the case of *Deckert v. Independence Shares Corporation*,²⁸ substantiates these assertions as to another sponsor company.

The court came to the following conclusions, among others:²⁹

(1) That the Independence Shares Corporation and its predecessor, Capital Savings Plan, Inc., furnished salesmen with written instructions as to methods and material to be used by them in selling the contract certificates.

(2) That said written instructions contained and suggested the use of untrue statements of material facts and the omission of vitally important relevant facts.

(3) That officers of the Independence Shares Corporation and its predecessor gave verbal instructions to salesmen which contained and suggested the use of untrue statements of material facts and the omissions of vitally important relevant facts.

Illustrating its conclusions, the court stated:³⁰

Miss Laura Burdette, a saleswoman for the Capital Savings Plan, Inc., testified (page 228, notes of testimony) that she was employed:

A. To go out and sell it to other people, anybody that wanted to buy it.

Miss Burdette stated that she was coached by a Mrs. Jane T. Balanos, a general agent of Capital Savings Plan, Inc. Her testimony (page 231, notes of testimony) is illuminating:

Q. What did she [Mrs. Balanos] tell you about the plan, and what to tell the customers?

A. She told me to go out and tell the customers that this Capital Saving Plan was a very good investment; it was better than a bank; it was better than a building and loan; it was better than anything on earth; and it had forty-two of the best companies in the country that were backing it up. The Pennsylvania Company was supposed—was one of the companies, one of the banks that was backing it up very, very much. I was supposed to emphasize that above everything else.

Participation in the Greatest Collateral in the World and take Earnings Compounded Quarterly instead of interest annually? And the best part of it is that you cannot do it any other way, unless you set up a Truusted Fund, unless you have individual capital of One-Quarter of a Million monthly."

²⁷ Op. cit. supra, note 23.

²⁸ Op. cit. supra, note 14; this case is discussed more fully in Sec. B, infra.

²⁹ Op. cit. supra, note 14, at 12.

³⁰ Id., at 15-16.

By the COURT:

Q. You say 'supposed to emphasize.' Were you told to emphasize it?

A. I was.

Q. That the Pennsylvania Company was one of the backers?

A. Yes * * *.

Miss Burdette also testified that Frank C. McGown, vice president of the defendant Independence Shares Corporation and its predecessor, was present at the conversation with Mrs. Balanos when she received sales instructions (page 233, notes of testimony). In connection with this incident, Miss Burdette testified that McGown told her not to say that the plan would run out in ten years, but that (page 234, notes of testimony):

A. Mr. McGown said, 'You don't sell it that way. Tell the people in seven and a half years they are going to get \$2,000.'

By the COURT:

Q. In seven and a half years on a \$10 payment per month?

A. That's right; but that was supposed to mature in seven and a half years.

Q. Did you have any literature in connection with this?

A. When I went to sell the people?

Q. Yes; with this seven and a half year proposition.

A. Yes; I did.

Q. I show you Exhibit C-3.

A. That is correct.

Incidentally, Miss Burdette, at the time she was employed as a saleswoman, was only 18 years old. She testified that among others whom she sold was a produce peddler. Another witness, Cosmo Balanos, testified (page 275, notes of testimony) that he was employed as a salesman by Capital Savings Plan, Inc.; that the company supplied him with a "sales kit," on the first page of which was a photograph of the doors of The Pennsylvania Company, &c.; that on the inside was a financial statement of The Pennsylvania Company, &c.; that next appeared a letter from a vice president of The Pennsylvania Company, &c.

With particular regard to the \$10-a-month investor, it is interesting to note the kind of charts alleged by one salesman to have been drawn by sales managers on a blackboard so that the men might copy and use them.³¹ One chart represented the installment plan as a method by which the "average man with average income" could eliminate the profits derived by "U. S. savings banks" and "American financiers" and obtain such profits for himself. Another chart compared the installment plan with a building and loan association and a savings bank, indicating that the installment plan would realize \$2,000 for the investor in 10 years and far more than the other programs. Another chart compared the installment plan and a savings account by portraying each of them as a pie and showing that under the savings-account method the savings bank would get a slice of the pie and the investor would get a small portion labeled "2% to you," whereas under the installment-plan method the larger slice of pie would inure to the benefit of the certificate holder, with only a small slice deducted. This salesman stated that this chart was to be used in selling installment plan certificates to housewives, "inasmuch as they would better understand the reference to pie."³²

³¹ Op. cit. supra, note 23, affidavit of William S. Becker, sworn to January 3, 1938, at 2-11.

³² Id., at 11.

In connection with the practice of employing part-time salesmen, sponsors employed office workers, public employees, factory workers, school teachers, and insurance salesmen to sell installment plan certificates as a side line.³³

Besides oral lectures, salesmen were given publications which were supposed to be for the personal use of salesmen, but it was admitted that the contents of these publications, when pertinent, were repeated to prospective purchasers.³⁴

Mr. Thomas testified that some of the material in one of these publications or house organs was "drivel" and sounded like "an evangelist":³⁵

Q. They are sales bulletins, and I would like to ask you whether you don't think that these savor of high pressure sales methods insofar as your salesmen are concerned. I have pulled out a few of them here—Trustogram No. 3, and entitled—

"Time to stop worrying."

"Draw aside the curtain and see the light."

And, "Depression's knock-out blow has landed on our courage."

And, "Our eyes are so tear-stained over lost dollars that we are blind to paralyzed courage, and that is the poorest way to recover lost dollars, for we will never repair the damaged purse until we repair the damaged morale of the men who own the purse strings."

And, "Tomorrow's sun will surely rise on a new world."

"The world is going on. Some men with applied intelligence and courage are going to carry it on. They are going to reap the spiritual and material rewards that go to the survivors."

"Other men are going to be crushed under or cast aside as the world irresistibly goes on its march of progress."

And, "In which class are you and I going to be found?"

And, "We must persuade people they need our service and through the opportunity offered by the FIF plan bring themselves out into the sunshine, where fear, anxiety, and the rest of the factors of mental worry can not and will not lurk."

With "Yours for success."

A. It sounds like a lot of drivel to me. I wouldn't say it is high pressure. It sounds like an evangelist.

One sponsor employed an independent lecturer on salesmanship to conduct "sales clinics," and salesmen attending these clinics received bulletins on salesmanship. In *Deckert v. Independence Shares Corporation*, the court referred to these bulletins as follows:³⁶

First as to the exhibits referred to. They included bulletins prepared by the Burton Bigelow Sales Coaching Clinic, at the request of the Capital Savings Plan, Inc. These bulletins were the familiar "high pressure" sales type. Just a few examples:

Bulletin No. 7—Every Earner is a Prospect! Don't be Afraid to Cold Canvass.

Bulletin No. 8—Making the Successful CSP Approach.

³³ Op. cit. supra, note 14, at 4.

³⁴ Public Examination, Financial Independence Founders, Inc., at 6424.

³⁵ Id., at 6421-22.

³⁶ Op. cit. supra, note 14, at 13-14.

Bulletin No. 9—Avoiding the “Premature Exit” or “Ease-Out” Before You Have Told Your Story.

Bulletin No. 10—Separating the “Suspects” from the Prospects.

Bulletin No. 11—Emptying the Prospect’s Bucket of Present Satisfaction.

Bulletin No. 12—Using the Re-Hook Question.

Bulletin No. 13—Re-Filling the Prospect’s Bucket with Desire Points.

Bulletin No. 14—Picturizing Future Life Money Needs.

Bulletin No. 16—Eight Ways for Handling CSP Resistances.

Bulletin No. 17—“The Words in Your Mouth”—Exactly What to Say When Handling the Most Frequently Met CSP Resisters.

The titles of these bulletins are eloquent evidence of the sales methods used by the defendant, Independent Shares Corporation, and its predecessor.

Plan holder after plan holder testified that the sales methods outlined in these bulletins were used on them to make sales.

Mr. Simonson, on the other hand, contended that “high pressure” sales methods were not used by his organization in selling the installment plan:³⁷

Q. Don’t you think that this is high pressure? You say, “Avoid Gloomy sales talk,” and then you give some sample arguments, and you say: “Imagine the gratitude and ready response of that man when approached by an adroit trust representative, who talks not of death but of life and of surcease from the manifold duties and perplexities of managing earthly possessions; who brings relief from the intricacies and worries of taxation, income and otherwise; who pictures vacations and travels with the assurance of freedom from personal business cares. From contemplation of the somber solitudes of death he is diverted to the pleasing prospects of enjoyment and freedom * * *.”

Don’t you suggest there is a very strong sales pressure, building up this beautiful picture?

A. No; and as we understand “sales pressure” in the Independence Fund of North America, it is a vigorous statement of fact.

Mr. Simonson insisted that the installment plan salesmen were not coached in high-pressure selling methods, despite the introduction into evidence of an article entitled “On Selling Women” which itself contains a statement about speeding “the closing by the use of direct, firm, quiet pressure.” Mr. Simonson testified:³⁸

Q. Don’t you tell them how to put on pressure?

A. I don’t know what you mean by telling them to put on pressure. If you are—do you mean do we tell them to sell? We certainly do.

Q. You certainly do. In other words, here is a magazine issue called “Trust Fund Profits,” dated October 1, 1936. I am going to offer all of these in evidence if I may; they are entitled, “On Selling Women,” and it says: “From the cradle to the grave you have sold and will continue to sell, women. Man, by his very nature, is continually asking of and receiving from women. Unconsciously, each of us builds for himself his own especial technique in dealing with the opposite sex. It is with this thought in mind that this memorandum is prepared. I am suggesting that we can each consciously improve that technique, each in our own way, and increase our sales potential through a more intensive drive for women clients.”

³⁷ Public Examination, Independence Fund of North America, Inc., at 6665-8.

³⁸ Id., at 6652-3.

And then you end up by saying: "There is more truth than poetry in the saying that 'A woman's "no" means "maybe"; and a woman's "maybe" means "yes."'"

That is signed by Douglas Laird.

A. Well, I take exception to your reading passages from that paper. You should read all of it into the record or leave it out, but you cannot just pick out a sentence here and there.

Q. All right. I will be glad to do that.³⁹

When examined on various statements made in the "Bigelow Bulletins" referred to above, Mr. Geary testified:⁴⁰

Q. Let's discuss these bulletins, Mr. Geary. I will start on Bulletin 1, page 2, a description of the Capital Savings Plan. "Neither does it cost anything to operate." Is that true or untrue?

A. That is untrue.

Q. "You are selling almost the only thing in the world that comes back with more money than it took originally to buy it." Is that true or untrue?

A. It should come back that way.

Q. It says, "You are selling almost the only thing in the world that comes back with more money than it took originally to buy." Is that true or untrue?

A. It needs qualification.

Q. Without the qualification, would it be misleading?

A. I think so.

Q. Without having to read every phrase pertaining to saving, is it not true that those bulletins generally emphasize saving?

A. Yes, sir.

Q. For example, Bulletin 2, page 1, discussing Saving. "You must first arouse in him a desire to save more, arousing a basic desire in the prospect's mind—a desire to save more." Page 2 of the same Bulletin: Need for additional saving. "He must," speaking of the Capital Savings Plan salesman, "he must convince Mr. Brown that the C. S. P. program is a better method of saving to use in his future program than the method he is now using." Are those the methods approved by the officers of the Capital Savings Plan, Inc.?

A. We don't make comparisons.

Q. In the first place, is the Capital Savings Plan a method comparable to the usual method of saving?

A. No, I would say not.

Q. "Your task is to dissatisfy him with his present method." Do you approve of such instructions to your salesmen, Mr. Geary?

A. No, I do not. I have never given such instructions.

Q. Do you advise Capital Savings Plan salesmen to postpone any discussion of price when this subject is brought up?

A. What do you mean by price?

Q. Costs of Capital Savings Plan.

A. No.

Q. "This strategy of postponing price." That would be a strategy not approved by the officers of the Company?

³⁹ The article is set forth in full in Appendix D.

⁴⁰ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on June 3, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 76-81.

A. No.

Q. Is this true, untrue, or misleading? "Did you ever hear of an easier, safer plan for a man like you to quickly and safely accumulate a cash estate?"

A. That is a misleading statement.

Q. What do you think of a statement like this, Mr. Geary? "Bulletin 4, page 3, under the heading The Motive Power of a Sale. 'The Pushing Power of Pain and Loss Plus the Pulling Power of Pleasure and Gain is a combination of Sales Motive Power that Gets Results.'" Is that the way you want your people to go out and sell these plans?

A. I think some of those ideas are a little high-pressure, yes.

Q. Same Bulletin, "Use Minus Points to Blast him out of His State of Contentedness." Does that sound like "high-pressure" to you, Mr. Geary?

A. Yes.

* * * * *

Q. In Bulletin No. 8, pages 1 and 2, Mr. Bigelow discusses the taking of an insured person out of his apparently life insurance policy and selling him a three year term insurance policy with part of the proceeds of the cash value of his own policy. Mr. Bigelow says this: "Some insurance men may dislike the ethics of this sale. We are not discussing ethics; we are discussing the means by which you get in to see your prospect." Do you wish your sales persons to disregard ethics?

A. No.

Q. Do you approve of such a statement?

A. No, I would not. We always give instructions to our organization that we would not have a man switching from insurance or anything else.

Salesmen were also provided with "sales kits"⁴¹ which consisted of the sales promotional material published by the sponsor company. Pamphlets, circulars, brochures, charts, letters of recommendation, facsimile checks, and other forms of sales material were thus made available to the salesmen in their oral presentation.

B. SALES PRACTICES

Numerous complaints have been made by certificate holders with respect to the installment plan certificates purchased by them, to the sponsor companies, installment plan trustees, and to the Securities and Exchange Commission. These complaints mainly concerned the low liquidating value of their certificates and the methods used by salesmen in making sales to them, ranging from the failure to state material facts concerning the nature, mechanism, and operation of the plan to direct misrepresentation.⁴² A widespread impression of certificate holders disclosed by these letters of complaint, more particularly those received by the Commission, was that the installment investment plans and sponsor companies were subject to federal regulation and were

⁴¹ See *In the Matter of Income Estates of America, Inc.*, 2 S. E. C. 434-6 (1937).

⁴² J. Montgomery Forster testified (Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Secs. 19 (b) and 20 (a) of the Securities Act of 1933, at 59-60):

Q. What were those complaints in the main?

A. Well, they varied. Some of them were where there had been downright misappropriation of funds. Others where there had been slight misrepresentations, not serious. There had been statements that there was insurance where, as a matter of fact, there had not been. There also have been other complaints that, in my opinion, furnished no real ground for complaint.

under the jurisdiction and direct supervision of the Securities and Exchange Commission. Officers of sponsor companies admitted that misrepresentations by salesmen had occurred, although they generally asserted that every effort was made to instruct and to supervise them properly.⁴³

In view of the various types of sales technique that were thus reputed to exist in the installment investment plan field, the Securities and Exchange Commission began in November 1937 to investigate the sales practices of various sponsors of installment plans. The practices of other companies were investigated subsequently.⁴⁴

The Commission, on the basis of these examinations, instituted injunction proceedings in the federal district courts against eight of the larger sponsor companies, charging them with violations of the fraud provisions of the Securities Act of 1933⁴⁵ and, in some cases, with violations of the registration provisions of the Act.⁴⁶ Six companies consented to the entry of a final decree in the federal district courts permanently enjoining them, their agents, and salesmen from committing any of the acts or practices complained of in the bills of complaint.⁴⁷ One company, Fundamerican Corporation, stipulated

⁴³ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on June 1, 1938, pursuant to order for investigation dated February 21, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 5-8; Hearings *In the Matter of Income Estates of America, Inc.*, held on June 30, 1938, pursuant to order for investigation dated April 19, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 19-20; Hearings *In the Matter of Benjamin Franklin Foundations, Inc.*, held on December 20, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 58.

⁴⁴ Some of these investigations were still pending as of August 1939.

⁴⁵ Section 17 (a) of the Securities Act of 1933 states:

It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

⁴⁶ Section 5 (b) of the Securities Act of 1933 states:

It shall be unlawful for any person, directly or indirectly—

- (1) to make use of any means or instruments of transportation and communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or
- (2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10.

⁴⁷ The six sponsor companies enjoined were:

(1) Benjamin Franklin Foundation, Inc., a Pennsylvania corporation. The injunction suit was filed on February 4, 1938, in the United States District Court at Newark, New Jersey, to restrain the company from violating the Securities Act of 1933 in the sale of Benjamin Franklin Foundation Trust Certificates. A final decree permanently enjoining the company, to which the company consented without, however, admitting wilful violation, was entered on February 10, 1938.

(2) Capital Savings Plan, Inc., a Pennsylvania corporation. The final decree in this case was granted by the United States District Court at Philadelphia on June 23, 1938, permanently enjoining Capital Savings Plan, Inc., from selling Capital Savings Plan Contract Certificates, in violation of the Securities Act of 1933. Independence Shares Corporation, a wholly owned subsidiary of Capital Savings Plan, Inc., was also enjoined. The defendants, Capital Savings Plan, Inc., and Independence Shares Corporation, filed a verified joint and several answer in which they consented to the entry of a decree as

that it, its officers, agents, and salesmen would refrain from violations of the Securities Act, and the injunction proceedings against it were stayed by agreement.⁴⁸ Another suit was pending as of June 1, 1939.⁴⁹

The companies, in their answers to the bills of complaint, generally denied the allegations charging misrepresentations and other fraudulent sales practices. Two sponsors⁵⁰ admitted "that some of the persons soliciting applications for certificates, acting contrary to the express instructions from the defendant, acting through its officers, and without the knowledge of the defendant or its officers, may have committed some of the acts complained of and accordingly consents that a decree may be entered in the above proceedings as prayed for in the said Bill of Complaint." One sponsor, Benjamin Franklin Foundation, Inc., admitted all the facts set forth in the bill although it denied wilful violation.⁵¹ All of these companies, except the latter, denied that they or their officers or directors committed any violations of the Securities Act, and stated that if there were any such violations, they were contrary to the orders and instructions of the defendant, its officers and directors.

The misrepresentations and other fraudulent practices alleged to have been committed by the sales personnel of the various sponsor companies were strikingly similar in all cases. These alleged misrepresentations and malpractices were in connection with a number of

prayed for in the bill, but in which they denied any wilful violation by the defendants or any of their officers and directors, and also denied each and every allegation contained in the Bill of Complaint except the jurisdictional facts and other averments concerning the organization of the defendants and the description of the plans.

(3) Financial Independence Founders, Inc., a New York corporation, was permanently enjoined on June 27, 1938, by the United States District Court of New Jersey from selling Financial Independence Founders, Inc., Certificates Series "D" and Diversified Trustee Shares, Series "D," in violation of the registration and fraud provisions of the Securities Act of 1933. The defendant's verified answer consented to the entry of the final decree, but specifically denied each and every allegation charging violation of the Securities Act of 1933.

(4) Income Estates of America, Inc., a Maryland corporation, was permanently enjoined on July 22, 1938, by the United States District Court for the Eastern District of Pennsylvania from violating the Securities Act of 1933 in connection with the sale of Truusted Income Estates Certificates. The verified answer of Income Estates of America, Inc., consenting to the entry of the final injunction decree, denied generally each and every allegation charging violation of the Securities Act of 1933.

(5) Lexington Foundation, Inc., a Delaware corporation, was permanently enjoined on September 12, 1938, by the United States District Court for the Southern District of New York from violating the Securities Act of 1933 in connection with the sale of Lexington Foundation Contract Certificates. The verified answer of Lexington Foundation, Inc., consenting to the entry of the final injunction decree, denied generally each and every allegation charging violation of the Securities Act of 1933.

(6) Wellington Foundation, Inc., a Delaware corporation, was permanently enjoined on January 11, 1939, by the United States District Court for the Southern District of New York from violating the Securities Act of 1933 in connection with the sale of Wellington Foundation Trust Certificates. The verified answer of Wellington Foundation, Inc., consenting to the entry of the final injunction decree, denied generally each and every allegation charging violation of the Securities Act of 1933.

⁴⁸ *Securities and Exchange Commission v. Robert W. Porter, Charles T. Cushman, and J. Howard Gillen (Fundamerican Corporation, Inc.)*, United States District Court for the Southern District of New York, File No. 1-472, order dated December 12, 1938.

⁴⁹ *Securities and Exchange Commission v. Foundation Plan, Inc., et al.*, United States District Court for the Southern District of New York, File No. 1-87.

⁵⁰ Income Estates of America, Inc. and Wellington Foundation, Inc.

⁵¹ Benjamin Franklin Foundation, Inc. denied that it was then engaged in the sale of the trust certificates involved, having ceased such sales on January 21, 1938.

different aspects of the plans. Thus, it was alleged that fees were minimized or not disclosed; that the investor was told that he could withdraw his money in full at any time; that the investor was told that the trust company was sponsor of the plan, was manager of the funds or guaranteed him against loss; that the investor was misled into believing that the plan was comparable to a savings bank account with a higher rate of interest; and that investors were promised a maturity value of sums ranging from \$2,000 to \$2,400 on a \$1,200 certificate. More specifically these allegations were as follows:

(1) Failure to disclose adequately to purchasers of certificates the nature and amount of the various fees and commissions which were deducted from their payments, particularly the double-loading charges.

(2) Misrepresentations that the money paid in by certificate holders could be withdrawn at any time without loss, whereas in fact a substantial part of the money was absorbed by fees, especially during the first year, and the balance was available only by liquidating the underlying securities purchased for the account of the certificate holder at its market value.

(3) Misrepresentations that the trust company acting as trustee under the plan was "in back of" and sponsored the plan. Other related misrepresentations alleged were that the trustee guaranteed the "maturity payment of \$2,000 in ten years," that the trustee operated the plan, and that the trustee managed the investment of the funds. In fact, however, the trustee did not sponsor the plan, did not guarantee any payments and did not operate the plan or manage the investment of funds.

(4) Misrepresentations that the instalment plan was like a savings-bank account but with a higher rate of interest, whereas in fact the plan was in no wise comparable to a bank account. The certificate holder was not entitled to the amount of his payments or any specific amount, but only the asset value of the securities credited to his account.

(5) Misrepresentations that for each \$1,200 paid in the certificate holders would receive \$2,000 or more in cash at the end of 10 years, whereas in fact the amount to be received at any time depended on the unpredictable fluctuating market prices of the common stocks underlying the trust shares.

(6) Misrepresentations that a certificate holder was guaranteed against loss, whereas in fact there was no such guarantee.

(7) Misrepresentations that certificates with insurance provided for a lump sum from \$1,200 to \$2,000 in cash to be paid to the named beneficiary upon proof of death, whereas in fact the insurance policy merely provided for payment for a lump-sum payment of the unpaid periodic payments to the trustee, and did not provide for the payment of any definite amount to a beneficiary.

(8) Misrepresentations that a certificate holder could borrow on his certificate at any time 80% or more of the amount paid in without paying interest, whereas in truth there was no definite borrowing arrangement, nor could there be any prediction as to what proportion of the money paid in might be borrowed at any time.

(9) Misrepresentations as to the annual return on the underlying investment.

Other allegations in some of these complaints were that sponsor companies employed salesmen without experience in the sale of securities and that they failed to instruct salesmen sufficiently to enable salesmen to explain adequately the operation of the plan. It was also alleged that the sponsors issued sales material for salesmen and the public, which literature was misleading and contained false statements. It was further alleged that sponsors prepared sales talks to be memorized and used by salesmen and charts to be copied and used by salesmen, which sales talks and charts contained misrepresentations and misleading omissions of fact.

These charges were in general substantiated by the Federal District Court in the recent case of *Deckert v. Independence Shares Corporation*⁵² concerning one of these sponsor companies. In that case certificate holders sought to recover, under Section 12 of the Securities Act of 1933, payments made on installment plan certificates sold to them by the defendant sponsor company. The court rendered an opinion in connection with motions to dismiss the complaint made by the defendants and an application for a receiver made by the plaintiffs. After stating the facts in connection with the Commission's injunction proceedings against Capital Savings Plan, Inc. and Independence Shares Corporation, the court stated:⁵³

In essence, the instant proceeding is based on the same grounds as was set forth in the 1938 Securities and Exchange Commission complaint. The testimony adduced at five or six hearings held in the instant case overwhelmingly substantiates the allegations in the two proceedings.

The court denied the motions to dismiss the complaint and withheld its opinion on the application for the appointment of a receiver pending a determination of the issue of solvency of Independence Shares Corporation. However, the court discussed the merits of the case at length. In summarizing its conclusions the court stated:⁵⁴

As to the merits:

As previously stated, the testimony overwhelmingly substantiated the allegations in the bill of complaint that there were untrue statements made to purchasers in the sale of contract certificates, and that there was concealment of fact, of which untruths and concealments the purchasers were unaware.

Taken as a whole, the testimony and exhibits offered in evidence disclosed, in summary:

(1) That the Independence Shares Corporation, and its predecessor, the Capital Savings Plan, Inc., furnished salesmen with written instructions as to methods and material to be used by them in selling the contract certificates.

(2) That said written instructions contained and suggested the use of untrue statements of material facts and the omissions of vitally important relevant facts.

(3) That officers of the Independence Shares Corporation, and its predecessor, gave verbal instructions to salesmen which contained and suggested

⁵² United States District Court for the Eastern District of Pennsylvania, opinion dated May 18, 1939. Independence Shares Corporation was merged with Capital Savings Plan, Inc. on December 31, 1938.

⁵³ Id., at 7.

⁵⁴ Id., at 12-13.

the use of untrue statements of material facts and the omissions of vitally important relevant facts.

(4) That the Independence Shares Corporation, and its predecessor, employed salesmen from every walk of life without necessary and proper qualifications, and solely because of the fact that they were in a position to sell fellow employees, relatives, friends, neighbors, and persons with whom they enjoyed business relations.

(5) That purchasers were told that the plan was a "savings" plan; that the plan was comparable to a savings bank account but paying a higher rate of interest.

(6) That purchasers were told The Pennsylvania Company, &c., was the "backer" of the contract certificates.

(7) That purchasers were told that The Pennsylvania Company, &c., "guaranteed" \$2,000 for every \$1,200 paid in over a ten-year period at the end of ten years.

(8) That purchasers were told \$60 was the sole "service charge," when, in fact, \$60 was the initial service charge, and there were other charges including a nine percent overwriting collected by the Independence Shares Corporation, and its predecessor, on all shares placed in the investment portfolio of the plan purchaser (the nine percent overwriting now reduced to seven and one-half percent).

(9) That purchasers were told The Pennsylvania Company, &c., was in sole and complete control of the "investment" of funds paid in by the contract-plan purchasers.

(10) That there was misstatement and concealment of material facts relating to the life-insurance features of the plan.

(11) That purchasers were told that money paid in could be withdrawn in full at any time, or after definite periods variously represented to be one, two, or three years.

(12) That purchasers were told the trustee's agreement (the agreement between the Independence Shares Corporation and its predecessor, and The Pennsylvania Company, &c.) "guaranteed" \$2,000 for every \$1,200 paid in ten years.

(13) That there was a concealment of charges made by the Independence Shares Corporation and its predecessor.

(14) That the Independence Shares Corporation maintained its own trading department to "make" a market for Independence Trust Shares, which were resold at a seven and one-half percent mark-up to plan holders.

C. SALES MATERIAL AND DEVICES

In general, the misrepresentations and the fraudulent practices disclosed in the previous section on sales practices had their counterparts in the sales material and sales devices used by installment plan sponsors. Fees were minimized or not disclosed; undue emphasis was placed on the trustee and trusteeship; supposed similarities between the plans and savings bank accounts, or insurance endowment policies were indicated; a "maturity value" or "termination value" was placed on the installment-plan certificate; withdrawal and borrowing privileges were enlarged upon; and glowing predictions of wealth and financial independence were made. The ensuing sections contain a brief discussion and illustrations of these principal practices.

1. Nomenclature

The installment investment plan was frequently sold, not as a program for investment in shares of common stock on a periodic payment basis, but as a "savings plan," "thrift program," "scientifically trusted program," "endowment" plan, "living trust," or under some similar designation. Sales campaigns seem to have been directed at the concealment of the real nature of these plans. A system of misleading terminology gave support to the unwarranted implications which might have been drawn by the \$10-a-month investor. Names of funds, sponsors, certificates, and plans were obviously selected because of their association in the public mind with savings banks, insurance companies, and even philanthropic institutions.

The titles of the following sponsors or plans (with the terms which might lead to confusion or misapprehension italicized) will illustrate this point: *Assured* Income Builders, Inc.; Benjamin Franklin *Foundation* Trust Certificates; Capital *Savings Plan*, Inc.; Trust *Endowment* Agreements; *Foundation* Plan *Endowment* Certificates; Individual *Assured* Estates *Endowment* Trust Certificates; *Insured* Investors Series A Certificates; Liberty *Thrift* Foundation Trust Certificates; *Assured* Independence Plan Trustee Certificates; *Thrift* Investment Certificates of Agreement; United *Endowment Foundation*, Inc.

The prevalence of the word "trust" is also to be noted throughout the industry's terminology. Certificate holders were called "beneficiaries," "depositors," and "founders." "Financial security" and "financial independence" are other terms used which may be considered misleading.

2. Literature

False representations, as such, are not the sole criticism of the installment plan sales literature. Equally important is the fabrication of a set of mistaken impressions in the mind of the investor concerning the nature and terms of the plan. By use of misleading representations, vague statements, dramatized and emotionally appealing language, and half-truths, an untrue picture of the plan was often produced. In such literature a particular statement was perhaps of no great significance in itself, but the cumulative effect of similar statements rendered the plan susceptible of misunderstanding.

In its opinion *In the Matter of Income Estates of America, Inc.*,⁵⁵ the Commission, in suspending the effectiveness of a registration statement filed by an installment investment plan sponsor, pointed out that the most serious deficiencies in the prospectuses resulted from the "cumulation of a series of distortions, some of them in themselves very slight."

Each statement cannot be viewed separately to determine the effect of the entire publication upon the reader. The context must be gathered by considering the items relatively and the cumulative impression

⁵⁵ 2 S. E. C. 434, at 438 (1937).

created. The following testimony of Mr. Simonson, of Independence Fund of North America, Inc., is pertinent:⁵⁶

Q. Who wrote this circular entitled "The Unemotional Minority"?

A. Douglas Laird, the vice president of the company.

Q. And in this booklet he attempts to give the fundamentals of investment, and emphasizes that business trends can be foretold with great accuracy; and I quote here: "The answer is, therefore, that it can be done. The turn of the tide can be foretold, not to an inch but certainly within a few feet. The turn of a season can be forecast, not to a day but certainly with a week or two. The temperature of a season can be gauged, not for each day but certainly on the average. The span of life for man is an open book to actuaries, but not the life of any one man. So, likewise, we know that, based upon averages and a study of past experience, future economic trends can be forecast to a worth-while degree."

The implication of that is that the "worth-while degree," which is indicated there, is with the same accuracy as in foretelling the tides, and in forecasting the seasons, and forecasting the temperature?

A. I disagree with you on the implication.

Q. You do?

A. Yes. I do not think they are relative. The fact of the matter——

Q. Why are they put together, then?

A. Well, they are entirely separate sentences, and it is just merely to bring out that there is a varying factor. Now, take, for instance, the temperature of a season can be gauged—not for a day, but certainly on the average. Now, that means that a season might be three months, and you might miss the whole season by one month, which is one-third of the total period of time.

Q. You say here, "Not to a day but certainly within a week or two"?

A. I am speaking about this one factor. So, on the basis of your missing the season by one-third of the time, you have the same situation that you may miss the turn of a trend of a seven-year cycle for one-third of the time and still have it to a worth-while degree. I think the factors are relative if they are thought through.

The problem of presenting the nature of the installment plan to the public so as to be entirely comprehended by prospective investors has been pointed out previously. Another illustration of the difficulty involved can be perceived in the following complaints of certificate holders to the sponsor, Independence Fund of North America, Inc., filed as a list of representative complaints, together with the comments of the sponsor:⁵⁷

SUGGESTED COMPLAINTS RECEIVED FROM SUBSCRIBERS

1. Client received impression from salesman that he represented Empire Trust Company, Trustee.

In such instances, after running down the complaint, we frequently found that the subscriber jumped to this conclusion through a misunderstanding of the sales presentation rather than through any misrepresentation on the part of the salesman.

⁵⁶ Public Examination, Independence Fund of North America, Inc., at 6641-4.

⁵⁷ Id., Commission's Exhibit No. 613.

2. Client did not fully understand service fee or how deducted.

Investigation of many such instances revealed that the client was advised of the total service fee but did not apparently understand that it was all deducted from the first year's payments, although this was clearly set forth in all literature and instructions to salesmen.

3. Client, upon being advised that they could effect withdrawal at any time, overlooked the fact that any unpaid service fee would be deducted at the time of withdrawal.

In many such instances we have found that the client was as much at fault in this respect as the salesman. It has been found that clients starting one of these programs have the intention of continuing it, and therefore do not pay enough attention to penalties involved if payments are not kept up, although they are explained by the salesman. These cases are due more to carelessness than to misrepresentation.

4. Clients have in some instances viewed the offering as a savings fund with results guaranteed.

Everything possible in the training of salesmen has been directed toward full disclosure of the fact that no dollar results are guaranteed under this program. Records of past performances have been used, but in no case has this been represented as a guarantee of future results. Some confusion in this respect exists because of other accumulative plan certificates now outstanding by other sponsors which are the obligation of the sponsors who guarantee a definite maturity value in dollars.

5. Clients sometimes do not appear to understand that by reason of the investment of their funds in equities, their underlying value is subject to market fluctuations and the element of time or the amount paid in is not the basis of their liquidating value which is only determinable by the market value of the securities in the fund as of any given date.

Salesmen, in the use of "Fact Not Theory," which is a record of actual accounts, endeavor to bring out the fact that the underlying fund varies with the market fluctuations of the underlying securities, but in spite of this there have been some few cases where it apparently has not been thoroughly understood.

Wilfully or unwittingly, sponsors apparently took advantage of the complexities of the plan to confuse and mislead investors instead of attempting to present a clear, unambiguous explanation. Thus, in many instances sponsors attempted to minimize the fees and charges to which the principal or income of the certificate holder was subject. Aside from direct misrepresentation of such fees and charges by salesmen and in published sales material,⁵⁸ there were devious methods of sales presentation by which such minimizing was accomplished. One method was to present the sponsor's service fee in conjunction with, or as a percentage of, the expected return at the end of the 10-year period. For example, note the following excerpt from a sponsor's selling literature:⁵⁹

How much will this service cost you? From every \$10 deposit, 25¢ is deducted and retained by the trustee as its Administration fee. A creation fee of 3.6% of the first maturity value (\$2,000 per unit) is deducted from your

⁵⁸ See Sec. B, *supra*.

⁵⁹ *In the Matter of Income Estates of America, Inc.*, 2 S. E. G. 434,441 (1937). This decision contains a detailed discussion of the deficiencies in a prospectus and registration statement filed by this sponsor.

first 9 deposits. There are no termination fees, no fines, or penalties of ANY KIND.

Another method was to present fees and charges as percentages and not in dollar amounts. For example, the following excerpts from sales circulars may be noted:

A service fee of 10% of the amount of the total contract is charged for the soliciting, collection, and handling of each account under Plans A, B, and C and for profit. This fee is deducted as follows: $\frac{4}{10}$ th thereof the first year; $\frac{2}{10}$ th thereof the second year; and $\frac{1}{20}$ th thereof each year thereafter. On Plan D only, the full service fee is 6% deducted at the time of original subscription.⁶⁰

Under Trust Plans A and B the investment period provided is ten years, and the total service fee of 5% therefore amounts to $\frac{1}{2}$ of 1% of the face amount per year, except that it is paid up during the third year. Similarly, in respect to Trust Plan C, under which the service fee is paid when the Trustor's payments are made, the amount of the service fee is equal to $\frac{1}{4}$ of 1% a year on the initial and first six months' payments only.⁶¹

In the following instance, the existence of the secondary sales load was only vaguely indicated. The nature or the amount of this load was not stated anywhere in the circular:⁶²

COST OF SERVICE

A fee of $7\frac{1}{2}\%$ of the amount deposited and to be deposited on an Endowment Certificate is charged for the service rendered in establishing and maintaining the Trust under the Foundation Plan. This fee, deductible from the first 12 monthly deposits or equivalent thereof, including the initial deposit, is for the purpose of paying Trustee's fees, distributive and administrative expenses, and profit to the Sponsors. Assuming the deposits extend over a period of ten years, this fee is equivalent to only $\frac{3}{4}\%$ per annum of the total amount of contemplated deposits. Said fee has no connection with or relation to fees or expenses in connection with the creation, issuance, and/or sale of Trust Units described herein. There is no service fee on the Paid-Up Endowment Certificate, which the Beneficiary is privileged to accept upon maturity of the original Certificate, and thereby, subject to the terms of the Trust Agreement, receive the services of the Foundation and the Trustee for an additional ten years.

The following paragraph from a sales booklet is meant to explain the operation of the installment plan but neither in this paragraph nor elsewhere in the booklet is the service fee mentioned or disclosed:⁶³

· HOW AN INSURED INVESTORS TRUST FUND WORKS

With the assistance of one of our Representatives, you decide on a plan that meets your present circumstances and provides for your future require-

⁶⁰ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 609.

⁶¹ Reply to the Commission's questionnaire for Commonwealth Fund Trust Certificates, Exhibit K-2.

⁶² Reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit K.

⁶³ Reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibit P-1.

ments—a plan that may be increased as your circumstances improve. Let us assume that you decide on a \$3,000 Trust Fund (see page 18). That means that you have decided to “put aside” \$25 a month for a period of 120 months. Each month, as your deposits are received, we (Insured Investors, Inc.) purchase, at the market price that day, shares in the aforementioned 32 corporations and deposit them in a Trust Estate which is established in your name with the Commerce Trust Co. of Kansas City, your Trustee (see page 13).

The emphasis on “savings” in the installment plan literature in an endeavor to meet the sales resistance of a prospective purchaser to a speculative incursion into the investment field, laid the foundation for possible misrepresentations by salesmen and tended to confuse or mislead the prospective purchaser. Statements concerning “withdrawal” fostered these mistaken ideas. Even deposit or payment record books issued to certificate holders closely resembled savings bank passbooks.⁶⁴ The attempt to have these passbooks resemble savings bank passbooks would not appear to be merely casual or coincidental. One sponsor issued a passbook resembling a bank passbook with the following statement on the leaf of the book:⁶⁵

You work 8 hours a day for your money; but the money you save works the whole 24 hours for you.

Payments made by certificate holders were often termed “deposits.”⁶⁶ Officers of sponsor companies have characterized the installment investment plan as a “thrift plan.”⁶⁷

Examples from sales material showing the stress on “savings” and the availability for withdrawal of the investor’s funds are as follows:

Building an Estate out of Income through the Wellington Foundation Trust Plan

“Save for Success”

“Be industrious and frugal and you will be rich.”

—Benjamin Franklin.⁶⁸

Nothing Can Take the Place of Well-Planned Saving⁶⁹

* * * During his productive years a man owes it to himself and family to save against that *inevitable tomorrow* when his services will no longer be required.

* * * * *

⁶⁴ The following quotation from *Deckert v. Independence Shares Corporation* illustrates this point (op. cit. supra, note 14, p. 18): “The Prospectuses time and again aim to sell the ‘fact’ that the plain holder, by subscribing, is entering upon a ‘savings’ program. The very designation ‘Capital Savings Plan’ speaks for itself. The book given to subscribers, so that entries might be made of their payments, is in the pattern of a bank deposit book.”

⁶⁵ Reply to the Commission’s questionnaire for Investors Independence Trust Share Certificates, Exhibit R.

⁶⁶ Reply to the Commission’s questionnaire for Foundation Plan Endowment Certificates, Exhibit S.

⁶⁷ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on December 17, 1937, pursuant to order for investigation dated November 23, 1937, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 6.

⁶⁸ Reply to the Commission’s questionnaire for Wellington Foundation Trust Certificates, Exhibit K-2.

⁶⁹ Reply to the Commission’s questionnaire for Insured Investors Series A Certificates, Exhibit P-5.

Naturally we want the assurance that the money we “put aside” is in safe-keeping. Then, too, we want the assurance that should an emergency arise calling for ready cash, our funds will be instantly available.⁷⁰

The plan is called the National Unit Cumulative Trust Fund. It employs the soundest known principle of thrift—systematic savings deposited in trust.

* * * * *

A depositor receives everything that his savings earn for him, without deduction.⁷¹

A TRUSTEED SAVINGS PLAN DESIGNED TO FIT THE NEEDS OF EVERY INVESTOR⁷²

When it comes to saving money, grown-ups are like children. They must have a reason or a purpose for saving. One thing you do want is to be relieved of financial worries. To be able to live as you wish—to travel, to be able to educate the children, to enjoy vacation trips and more of the luxuries of life.

All of these things can be accomplished if during the productive years of your life you adopt and stick to a systematic saving plan wherein your savings are scientifically invested and earning money for you.⁷³

While the program calls for 120 monthly deposits, a member may terminate at any time and withdraw cash in accordance with the provisions. This provision protects the member in case unforeseen conditions prevent him from completing his program. In other words, his funds are never “tied up.” His money is always safely administered and constantly working until called for by him.⁷⁴

The emphasis placed upon the “great corporations,” the common stocks of which underlay the installment plan, manifestly had the capacity of misleading the investor. Not only was there a tendency to confuse the soundness of the “great corporations” with the soundness of the installment plan, but many certificate holders were misled into believing that their money was directly invested in these securities rather than in fixed trust shares.

Thus, Insured Investors Series A Certificates had Trustee Standard Investment Shares, Series D, as the underlying medium. In several pamphlets, filed with the Commission, no indication of the “trust upon a trust” arrangement is given. The following statements appear in the sales literature:⁷⁵

THE BACKBONE OF INDUSTRY

An Insured Investors Income-Building Plan makes it possible for YOU to participate in the earnings of 32 leading industrial corporations of America, corporations upon whose functioning depends the very structure of our economic system. It is next to impossible to comprehend the vast scope and extensive operations of these great corporations—*next to impossible*, because we take their

⁷⁰ Id., Exhibit P-1.

⁷¹ Reply to the Commission's questionnaire for National Unit Cumulative Investment Certificates, Exhibit K.

⁷² Reply to the Commission's questionnaire for Euclid Investment Trust Certificates, Exhibit K.

⁷³ Ibid.

⁷⁴ Reply to the Commission's questionnaire for Future Requirements Plan Investment certificates, Exhibit K.

⁷⁵ Reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibits P-1, P-2, and P-3.

products, services, and activities for granted; they have become so integral a part of our daily lives. It is estimated that twenty cents of every dollar we spend eventually reach these great corporations and their more than 1,500 subsidiaries.

Individual Assured Estates Endowment Trust Certificates, for which Foundation Trust Shares, Series A, was the underlying medium, advertised that it provided a program through an investment medium as follows:⁷⁶

An investment unit of the common stocks of 29 dominant American corporations. They have an average age of 48 years; have combined assets of more than 20 billions of dollars; paid common-stock dividends in 1934 of 578 millions of dollars, an increase of 127% over 1924.

Another instance of this type of emphasis is as follows:⁷⁷

HOW ABOUT THE 47 COMPANIES? Capital Savings make you a partner in enterprises totalling 35 billions of dollars, with reserves in excess of 8 billion * * * time-tested concerns that have served the world for 20 to 130 years.

Sales literature expatiating on the concept of "trusteeship" often contained statements that the installment investment plan provided "trusts" or "estates" theretofore available only to wealthy persons. The "trust" of a wealthy person pictured by this literature would have differences in investment management and in cost, which made such comparisons subject to misunderstanding by prospective investors unless fully explained. Examples of such statements are as follows:

Previously the security, profit, and convenience of a Trust Fund was only open to the wealthy. The average person, not having a large sum of money, had to turn to haphazard methods of building an estate which were lacking in the safeguards of a Trust. You can now secure these advantages through a Systematic Method and a Definite Program.⁷⁸

Today—even on a small salary—you can set up a trustee estate like those hitherto available only to wealthy persons.

This is addressed to people who have their salary or wages—and nothing more. And who are thinking about their financial future.

Here is an opportunity you have never had before.

For it enables you to invest (through an old and conservative trust company) as little as \$10 a month—and have the earnings on your money *reinvested* automatically every six months. This means that the earnings on your investment are COMPOUNDED—according to a scientific, trustee-protected program. It means that through your monthly payment, small or large, you create your own TRUSTEED estate, getting the same investment advantages available hitherto only to wealthy persons.⁷⁹

⁷⁶ Reply to the Commission's questionnaire for Individual Assured Estates Endowment Trust Certificates, Exhibit K.

⁷⁷ Reply to the Commission's questionnaire for Capital Savings Plan, Inc., Exhibit K. See also the reply to the Commission's questionnaire for Foundation Plan Endowment Certificates, Exhibit K.

⁷⁸ Reply to the Commission's questionnaire for Wellington Foundation Trust Certificates, Exhibit K-2.

⁷⁹ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 605 (6-F).

A particular fault of the literature used in connection with the distribution of installment investment plan certificates was the assurance of safety of principal and regularity of earnings which it gave.

A few quotations from such material will serve to illustrate this point:

Commonwealth Fund Provides Living Assurance by Enabling You Now to—

Create a Living Trust for the education of your children.

To buy your own home or establish a business.

To provide a sinking fund or business reserve.

To meet an emergency or an opportunity.

For travel and comfort in your later years.

LIVING ASSURANCE means peace of mind—security and freedom from financial worry.⁸⁰

SUGGESTIONS AS TO WHOM AN INSURED INVESTOR'S LIVING TRUST MAY BENEFIT

People of Moderate Means

It is of particular benefit to the business man who wishes to place a part of his Capital beyond the risk of his business, especially should he be solvent and his Income such that, without a great sacrifice on his part, he can afford to create a Living Trust. By so doing, a business man assures a Future Income to his family, no matter what financial misfortune may befall him in coming years.

* * * * *

The Salaried Man and Woman

The man and woman with a comfortable salary who find they can save a definite sum every month, but who lack both training and experience in sound investment, can establish an Insured Investors Living Trust. It is the safest way for them to build an Estate that will assure a future Income for themselves and their families.

The Husband and Father

The Husband and Father who realizes the importance of settled habits, who can set aside enough to provide his Wife and Children with an Income that assures the comforts of life, an income that no one could ever take away from them, should not delay in establishing an Insured Investors Living Trust.

* * * * *

Women of Property

An Insured Investors Living Trust is of particular value to women of property who find the care of Capital distasteful and the hazard of it a source of anxiety, who have inherited property and want to be sure that it will be conserved and earn for them the maximum income consistent with safety.⁸¹

⁸⁰ Reply to the Commission's questionnaire for Commonwealth Fund Trust Certificates, Exhibit K-2.

⁸¹ Reply to the Commission's questionnaire for Insured Investors Series A Certificates, Exhibit P-2.

NO MORE MONEY WORRIES

What could be nicer than a Comfortable Old Age, with an assured monthly income from your own estate? Regular dividend checks. Freedom from financial worries. Let the profits of American Industry help you build your estate.

WILL YOU SOME DAY BE ABLE TO TRAVEL OR PURSUE YOUR FAVORITE HOBBY?

How many of us are really free? Free to travel and visit foreign lands and see strange sights? Free to pursue our favorite hobby of fishing, hunting, golf, or whatever it might be to our heart's content? To do these things we must be Financially Independent, which means mental and physical freedom. To be mentally and physically free, we must have a satisfactory income from our own estate. The Hamilton Plan offers you an ideal Estate Building Program.

A COLLEGE EDUCATIONAL FUND

"This means a college education for you, son, no matter what happens." That is what the father is saying to his son in this picture. The father has adopted a definite, systematic program to create an educational fund for his son with the HAMILTON PLAN OF ESTATE BUILDING.⁸²

An illustration of misleading sales literature used by the installment-plan sponsor and the types of misrepresentations contained therein is afforded by the following testimony of Mr. Geary:⁸³

Q. Would you say that Geary Exhibit No. 39 correctly describes the Capital Savings Plan?⁸⁴

A. No, sir. It is an attempt at a brief summarization of the Plan.

Q. Would you say that the Capital Savings Plan enables a purchaser to enjoy unlimited profits?

A. Not the purchaser, but the opportunity to enjoy unlimited profits.

Q. Would you say the Capital Savings Plan maintains the liquidity of the invested dollar of the purchaser of a contract?

A. No; I think that is a misleading statement.

Q. Would you say the Capital Savings Plan provides all of the advantages to those of small or moderate income that heretofore have been available to the enormously wealthy?

A. No; I think that is an exaggerated statement.

Q. Is it misleading?

A. Yes; unless amplified.

With respect to the representations in the literature that the investor's savings were protected, Mr. Geary testified:⁸⁵

Q. Would you say the Capital Savings Plan provides protection for your savings?

A. Merely unqualified—protection for your savings?

⁸² Reply to the Commission's questionnaire for Hamilton Trust Share Certificates, Exhibit 1-3.

⁸³ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on June 2, 1938, pursuant to an order for investigation dated February 21, 1938, under Secs. 19 (b) and 20 (a) of the Securities Act of 1933, at 41-3.

⁸⁴ The exhibit referred to is contained in Appendix E.

⁸⁵ Op. cit. supra, note 83, pp. 42-3.

Q. Yes.

A. It really provides an investment medium for your savings.

Q. And not protection for your savings? Is there any protection? It is not deposited in a savings bank.

A. Savings bank don't provide protection.

Q. Would you say your Capital Savings Plan provides protection for your savings?

A. No, I think that is a term that is misused in that connection.

Q. And, therefore, with the term "protection" it is a misleading statement?

A. It doesn't mean very much, it seems to me.

Q. Does Capital Savings Plan provide protection for savings?

A. I am inclined to think "protection for savings" are the wrong words.

Q. And the word "protection" unexplained or unqualified is misleading?

A. Yes, sir.

Q. Would you say that any Capital Savings Plan contract certificates provide the necessities of life under any economic condition?

A. No.

Q. Is such a statement misleading?

A. Yes, sir.

Concerning the representations of assurance of profits and absence of any speculative elements in the plan, Mr. Geary testified:⁸⁶

Q. Would you say that under the Capital Savings Plan that a Capital Savings Plan certificate provides profit for your savings?

A. No, it provides a means through which your savings may be invested.

Q. So the term "profits on your savings" is misleading?

A. I think so.

Q. Is the Capital Savings Plan a cooperative method of saving and investing money?

A. No, not in the strict sense of the word.

Q. Are the underlying securities for Capital Savings Plan the common stock for 42 corporations of the basic industries of America?

A. No.

Q. What is the underlying security for the Capital Savings Plan?

A. Independence Trust Shares, which in turn, have, as underlying securities 42 corporation stocks.

Q. Is this statement correct: "The 42 underlying stocks are bought with the investors' money and held in trust by The Pennsylvania Company?"

A. No, sir.

Q. Is that untrue?

A. That is untrue.

Q. May I ask you this, Mr. Geary: "There is no speculation possible under the Capital Savings Plan system of saving and investment." Is that true or untrue?

A. Depends upon the interpretation of the term "speculation."

Q. Would you say there is no speculation at all possible under the Capital Savings Plan system?

A. I would say the values, of course, fluctuate. Speculation in that particular sense was used to indicate short selling or margin purchasing.

⁸⁶ Id., at 43-5.

Q. The statement alone without any qualifications covering margin and short selling? Would you say this is misleading or not: "There is no speculation possible under the Capital Savings Plan System of Saving and Investing."

A. I think that is a misleading statement.

So, too, with respect to the fees and "maturity" value of the certificates Mr. Geary testified:⁸⁷

Q. Would you say under the Capital Savings Plan that there can be no additional fees charged and there can be no penalties?

A. No, I think that is not a correct statement.

Q. Is it misleading?

A. It is misleading, providing additional explanation is not offered.

Q. Would a statement like this without further explanation be misleading: "A Capital Savings Plan has a maturity value far in excess of your actual savings"?

A. Yes, sir.

Q. Is this statement misleading, Mr. Geary: "A Capital Savings Plan may be liquidated any day during regular trading hours and upon liquidation you will receive the full market value of your invested dollar, plus all of its accumulation and profit"?

A. The words "Invested dollar" are misused.

Q. Which renders the statement, without additional explanation, misleading?

A. Yes, sir.

Q. Would you say this is misleading: "The purchasing power of your savings and your profits are assured no matter what the purchasing power of the dollar might be in years to come"?

A. I think that is misleading.

* * * * *

Q. Let me read you this: "Money borrowed on your Plan carries no interest." Is that true or untrue, or is it misleading?

A. Misleading.

Q. "Such a procedure is considered a partial liquidation and may or may not be replaced; this is optional with you." Is the use of the term "borrowing" when applied to such a liquidation, misleading?

A. Very definitely, yes.

* * * * *

Q. Let me conclude with this paragraph entitled, "The Cost." "A Capital Savings Plan earns profits for you without limitation." Is that misleading?

A. Without any further qualification, yes.

Q. I will continue: "And you are able to enjoy the benefit of large investing power, though you only save in small monthly amounts. In your total cost for the benefit of a Capital Savings Plan Certificate is only the small service fee, as provided for in the Capital Savings Plan prospectus." Is that true or untrue?

A. Well, the prospectus covered the complete cost, but that refers to only one item; therefore, it is not true.

Mr. Geary stated that he had not approved this sales material and that it was "a slip-up in the machinery."⁸⁸

⁸⁷ Id., at 47-9.

⁸⁸ Id., at 50. It may be observed, however, that many statements contained in this pamphlet and stated to be misleading by Mr. Geary were also contained in literature issued by his company and other sponsor companies. Reference is made to the quotations from sales material set forth in the preceding pages of this section.

3. "Projections" and Performance Representations

Imposing charts and statistical material formed a considerable part of the sales approach of the installment plan distributor. Naturally, the statistics and analyses presented to the public were favorable to the plan. Periods of time were chosen when they particularly favored the interpretation desired by the sponsor. Past performances of securities in the market were projected into the future to "prove" the selling argument of the sponsor. "Projections," upon which "reasonable predictions" were made, even selected general security prices as far back as 1900 and 1910 to show the probability of the appreciation of the underlying stocks in the future.

In the presentation of statistical information to the investor, the sponsor selected a particular period which was most favorable to the installment plan and which, while technically accurate, might have been a distortion of the facts.⁸⁹

The following testimony of Walter L. Morgan, president of Wellington Fund, Inc.,⁹⁰ clearly shows the unfair results which may be achieved by a biased choice of stock prices at selected periods of time:⁹¹

Q. The statement under the caption, "Wellington Gain Per Share, 43.24%," that refers only to the gain between the period from January 1, 1934, to January 1, 1938, and not the average gain over the period of the trust, doesn't it?

A. This is the total increase in the market value per share between those two dates with the dividends paid in the interim added to the total appreciation.

Q. Now, I notice that the price of shares on January 1, 1934, was \$11.54, is that correct?

A. Well, I'll have to look at that. That's right.

Q. And the price on January 1, 1938, was \$12.48?

A. That's correct.

Q. This percentage gain holds true between those two dates, but supposing you were to take the example of February 1934, at which time the price was \$13.35 and compare that with the price of February 1938, at which time the price was \$12.45, there would be quite a difference, would there not, in the gain, if any?

A. What are those figures?

⁸⁹ Mr. Simonson gave the following testimony (Public Examination, Independence Fund of North America, Inc., at 6649) :

Q. So that that information starts out October 8, 1934, and goes to May 25, 1935, and the other information you start on March 19, 1935, and it goes to May 11, 1935?

A. Well, there were probably other reports that covered those other subjects in different periods.

Q. Would that not indicate to you that you have picked out particularly favorable periods to impress the investor with?

A. [Examining papers]. These are not people that we are trying to sell this offering to; these are people who have bought this offering in the past; and therefore the idea is to let them know now how their investment is progressing.

Q. And to resell them, is it not?

A. Do you mean to sell them additional?

Q. To sell them additional; your salesmen's instructions show that?

A. Yes.

Q. That is right, is it not?

A. Yes.

Q. So that you tried to put out the best picture? Didn't you?

A. I would say; yes.

⁹⁰ Shares of Wellington Fund, Inc. were used as the underlying security for Wellington Foundation Trust Certificates.

⁹¹ Hearings *In the Matter of Wellington Foundation, Inc.*, held on December 15, 1938, pursuant to order for investigation dated October 22, 1938, under Sec. 19 (b) and Sec. 20 (a) of the Securities Act of 1933, at 30-1.

Q. February 1934, \$13.35; and February 1938, \$12.45.

A. About 25%.

Q. So the figures shown on page 4 refer solely to a person who may have bought on that particular day in January 1934, and sold out on that particular day in January 1938?

A. That is still not correct. That refers to the market value on January 1, 1934, and the market value in January 1938.

Q. Mr. Morgan, what would be the result or the percentage gain from the price of the shares on February 1, 1934, and the price of shares on February 1, 1938?

A. As far as Wellington Fund was concerned, that would be, in round figures, 25%. I presume the other would be comparatively lower.

Q. So that taking any certain figures on any certain day and comparing that with a period four years hence, in doing that there might be a variation of the gain, in some cases, maybe, a loss?

A. That's correct.⁹²

The unfairness of "projections" and their tendency to mislead were perhaps rendered less harmful by statements sometimes accompanying the "projections," to the effect that the projected figures were merely estimates and that the investor must judge for himself as to the chances of their being realized. Such statements, however, presupposed investment judgment on the part of the subscriber. Furthermore, the possibilities for abuse in the use of such projections remained. Salesmen could still take advantage of a credulous prospect. The figures were misleading and did not give a complete picture of the hazards involved.

An example of a projection containing such a statement appears in an early offering circular used for Independence Fund Participation Agreements. The period of time selected—1920 to 1929—is to be particularly noted.⁹³ The projection, termed "Statistical Record," is as follows:⁹⁴

STATISTICAL RECORD

The following figures projected on annual averages are based upon the distributions that would have been received on Independence Fund Participations, had North American Trust Shares and Independence Fund of North America been in existence for the ten-year period beginning 1920 and assuming Independence Fund is liquidated at the average price of North American Trust Shares in 1929. *The investor must judge for himself whether or not the corporation whose securities*

⁹² Mr. Morgan submitted the following comment on his testimony: "The examiner was considering the fact that the Wellington Fund management record for 1937 showed a gain of 43.24% between January 1934 and January 1938 and that if other periods were used the results would be different. This testimony would probably be clearer if it were made to read that statistics of such type do not necessarily measure the profit or loss to the investor since they are merely statistical studies based on asset or market values without sales commissions and since they are designed to show management results over an extended period. It is obvious that statistical results for different periods or portion of periods might be less favorable or more favorable but it is very important to realize that the gain or appreciation shown for a specific period is only informative when compared with the gain or appreciation in other investments or with what an individual might have accomplished in his own investments."

⁹³ The first installment investment plan was introduced in 1930.

⁹⁴ Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 609. The use of the term "record," implying past experience, is to be noted.

underlie North American Trust Shares will earn more or less the next ten-year period.

PLAN A (WITH INSURANCE)

Annual payment	Total deposit, 120 months	Estimated projected value at maturity
\$120.00	\$1,200.00	\$2,431.85
-----	-----	-----
960.00	9,600.00	19,454.80

PLAN B (WITHOUT INSURANCE)

Annual payment	Total deposit, 120 months	Estimated projected value at maturity
\$120.00	\$1,200.00	\$2,627.03
-----	-----	-----
1,200.00	12,000.00	26,270.30

PLAN C (WITH \$10,000 MAXIMUM INSURANCE)

Annual payment	Total deposit, 120 months	Value at maturity
\$1,200.00	\$12,000.00	\$24,381.50

PLAN D (FULLY PAID CERTIFICATE NO INSURANCE)

Amount invested	Estimated projected value in 10 years
\$500.00	\$1,778.93
1,000.00	3,557.87
-----	-----
50,000.00	177,893.33

On the first page of this same offering circular appears a summary of various matters taken up on subsequent pages, including a summary of the statistical record, this time designated as "Past Record," an obviously misleading designation. It is to be noted that the qualifying statement was entirely omitted. The summary is as follows:⁹⁵

PAST RECORD

Had Independence Fund Participations and North American Trust Shares been in existence for the 10-year period beginning 1920, and assuming liquidation at the average price of North American Trust Shares in 1929, the results would have been as follows:

Plan	Annual payment	Total payment in 10 years	Projected value in 10 years
A	\$120	\$1,200	\$2,431.85
B	120	1,200	2,627.03
C	1,200	12,000	24,381.50
D	Fully paid.	1,000	3,557.87

Practically all plans used "projections" in order to sell the prospect; some predictions even reckoned to the penny. A partial list of such predictions reveals a variation of results which taken alone

⁹⁵ Ibid.

would demonstrate the utter unreliability of the "statistics." The bases for the "statistics" varied but were in general based upon average prices of high-grade common stocks for 10-year periods. The variations were thus probably due to selections of favorable periods of time or prices, or actual inaccuracies. The list is as follows:⁹⁶

Name of plan	Amount paid in	Predicted return—	
		In 10 years	In 20 years
American Participations Certificates.....	\$1, 200	\$3, 302. 59	\$15, 882. 15
Capital Savings Plan Contract Certificates.....	1, 200	1, 948. 28	-----
Corporate Leaders Trust Certificates.....	1, 200	3, 200. 00	-----
Hamilton Trust Shares Certificates.....	1, 200	2, 665. 08	7, 346. 70
Independence Fund Participation Agreements.....	1, 200	2, 627. 03	-----
Individual Assured Estates Endowment Trust Certificates.....	1, 200	3, 247. 00	19, 176. 00
Insured Investors Series A Certificates.....	1, 500	2, 720. 14	8, 579. 64
National Trustee Fund Contract Certificates.....	1, 200	2, 169. 85	-----
National Unit Cumulative Investment Certificates.....	1, 200	2, 242. 00	-----
Thrift Investment Certificates of Agreement.....	1, 500	4, 200. 00	-----

When questioned concerning these predictions, Mr. Simonson testified:⁹⁷

Q. What would you say to a representation made to a purchaser of one of these certificates that based upon careful statistical analysis, a conservative estimate of their worth at the end of the ten-year period of time would be \$2,000 per \$1,200 unit? Do you think it would be a safe prediction?

A. I would say that no such prediction can be made, because not only is it not founded on fact, but insofar as the future is concerned, you can't tell; and while it may mature, terminate, or be worth more than \$2,000 at the end of 10 years, it may be worth very much less.

Q. It might even be worth less than the amount paid in?

A. It might be less than the amount you paid in, depending entirely upon the action of the securities in the fund.

Q. As a matter of fact, in the operation of these plans, an investor purchasing one in effect is indirectly investing in common stock, isn't that right?

A. Insofar as these two, the Trust Certificate and the Participation Agreement, are concerned, that is correct.

Q. And he has to take the risk of the rise and fall in the market?

A. Correct.

Q. There is no definite assurance of any value of one of these accounts at the end of the life of the account, or when the payments have been completed?

A. Absolutely none as to amount.

Similar "projections" or hypothetical performance records were used by the depositors of fixed trusts in their sales literature.⁹⁸ One of the regulations of the New York Stock Exchange concerning the

⁹⁶ All figures are taken from exhibits filed with the replies to the Commission's questionnaire.

⁹⁷ Hearings *In the Matter of Benjamin Franklin Foundation, Inc.*, held on April 4, 1938, pursuant to an order for investigation dated March 31, 1938, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 1541-2.

⁹⁸ See the Commission's supplemental report on Fixed and Semifixed Investment Trust, Ch IX.

requirements of a fixed trust which sought a place on the Exchange's "unobjectionable list" was that the fixed trust use no "projections" or hypothetical performance records. This ruling was as follows:⁹⁹

No statement or computation may be included tending to reflect results, either as to market valuation or as to distributions, which would have been obtained if an investment had been made in the securities comprising the portfolio at any period prior to its creation. Any statement or computation of this character for periods after the creation of the trust in question must go back to the beginning of the trust, and must show the result by years since such creation.

4. Emphasis Upon the Trustee and "Trusteeship"

Unwarranted and undue emphasis was given to the "trust" features of the installment investment plans in their sales publicity as well as in their set-up. This emphasis was apparent in the indenture, the certificates, the application form, the pass book, notices and all the sales literature of the installment investment plan. It was undoubtedly present in the salesmen's presentations. Little heed was given to the fact that the trustee's duties were merely custodial and ministerial. The sponsor gave little attention to the inconsistency between the actual functions of the trustee under the installment plan and the impression of the functions of the trustee received by the public. Exoneration clauses made the reasons for the attention devoted to "trusteeship" in the plan even more tenuous.

To the extent that the trustee institution and the "trust" aspect of the plan were unduly stressed as an aid in selling the installment plan certificates, such usage was unjustified and misleading. The Commission, in its opinion *In the Matter of Income Estates of America, Inc.*, discussed this situation fully:¹⁰⁰

The stipulation of facts further concedes and we find as a fact that the prominence accorded to the name of the trustee, by position and typography, is misleading. The passage particularly challenged sets forth the name of the trustee, the Pennsylvania Company for Insurances on Lives and Granting Annuities, on the first page of the prospectus in bold type above the name of the registrant, which thus becomes subordinate.

In other passages of the prospectus, likewise, the name of the trustee is brought into unwarranted prominence. A whole column of Part I, headed "Your Trustee," is devoted to a recital of routine custodial and other functions of the trustee, following upon the paragraph:

"Your trust estate is safeguarded and administered by the Pennsylvania Company for Insurances on Lives and Granting Annuities, of Philadelphia, Pennsylvania. This is one of America's oldest trust companies, having been founded in 1812."

Similar information is repeated in Part II, in other language. The Commission's rules require this information to be presented in the prospectus (Rule 832), but to reiterate it coupled with undue emphasis on the name and age of the trustee, where the registrant is a new and a completely unknown corporation, appears to us to be an unjustified attempt to trade on the reputation of the trustee.

⁹⁹ Id., Appendix K.

¹⁰⁰ 2 S. E. C. 434, at 443 (1937).

We have stated in a report to the Congress on the subject of corporate trustees (Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective Committees, Part VI, Trustees Under Indentures (1936), pages 3-4) :

"Upon the public distribution of bonds, debentures or notes, secured by an indenture, the name of a prominent institution which will act as trustee is eagerly sought. The addition of the name of such an institution to the prospectus is not without advertising value to the distributor. Likewise it is not without significance to the prospective investors. Persons are undoubtedly influenced to purchase securities by the size, prestige, and financial strength of the trustee. As stated by the United States Supreme Court over fifty years ago :

"The salability of railroad bonds depends in no inconsiderable degree upon the character of the persons who are selected to manage the trust. If these persons are of well-known integrity and pecuniary ability, the bonds are more readily sold than if this were not the case."

"This statement applies equally to other securities, regardless of the business of the issuer."

The misleading effect of registrant's emphasis on the position and importance of the trustee arises specifically from the fact that the trustee is probably the least important of any of the agencies acting in connection with the investment plan. If the trustee had any discretion in the matter of actual investment we would be less disposed to regard the prominence accorded its name in this prospectus as misleading. However, since the trustee can invest trust funds only in shares of an underlying investment trust, actual investment management is effectively delegated to the sponsor of the trust, leaving the Pennsylvania Company in the position of a bare custodian conduit.

Emphasis upon the "trustee" and "trusteeship" naturally would lead the "unsophisticated" investor to assume that the functions of the trustee afforded his investment the protection of supervision and management ordinarily ascribed to a trustee.¹⁰¹ For example, this

¹⁰¹ As evidence of the fact that misunderstanding may arise from the stress on "trusteeship" in the sales presentation, the following quotation from a list of complaints received from subscribers compiled by the sponsor company, Independence Fund of North America, Inc., for the Commission, may be cited (Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 613) : "(1) Client received impression from salesman that he represented Empire Trust Company, Trustee. In such instances after running down the complaint, we frequently found that the subscriber jumped at this conclusion through a misunderstanding of the sales presentation rather than through any misrepresentation on the part of the salesman."

Other illustrations of this misunderstanding prevalent among certificate holders are the following letters from the Pennsylvania Company for Insurances on Lives and Granting Annuities to certificate holders (*Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc., et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, Exhibits Nos. 18 and 19) :

We are in receipt of your letter of February 15 relative to Benjamin Franklin Foundation, Inc., and regret very much to advise that you have been misinformed on this subject. Our Company has nothing whatever to do with "the management of the funds."

Answering your letter of February 3 relative to Benjamin Franklin Foundation, Inc., I take pleasure in advising that we have acted as Trustee ever since the incorporation of the plan about a year and one-half ago and during this time our experience has been quite satisfactory. We believe confidence is warranted in the management of the Company and see no reason why anyone should hesitate to make a connection with them.

However, there is a misunderstanding in your letter which I am very frank to call to your attention. The misunderstanding centers around the paragraph in your letter in which you say you understand that our Company supervises the purchases of the securities in the Foundation. This is not correct—our Company has nothing whatever to do with the purchase of these securities. The backlog for the investment account consists of Truusted Industry Shares, which are supervised by A. Vere Shaw and Company, Investment Counsellors of New York City.

impression would inevitably follow from statements in installment plan literature concerning the "old, conservative trust company" acting as trustee.¹⁰² The linking of the conservative nature of the trustee institution with the investments made by the trustee for the certificate holders, in the sales literature, caused such an inference to be readily adopted. Mr. Barton admitted that the small investor had little knowledge of the lack of supervisory power of the trustee in the plan:¹⁰³

Q. But they [the trustee] have no control over it?

A. They have no control over the investment. They do not manage the investment.

Q. How clearly do you think that fact, that the trustee has no control over the management, has no control over the securities in the portfolio, is known to your investors?

A. To the small certificate holder, he has probably very little knowledge of that. He would not understand it if you explained it, and we do try to explain it in every possible way.

Actually the trustee had no managerial or discretionary power save in a few rare instances and was virtually completely relieved of all responsibilities by numerous exoneration clauses. Yet, in its desire to engender the "trust" notion in the mind of the investor, the installment plan sponsor placed the trustee institution in a position of close contact with him. Thus most plans provided that the tasks of "authenticating" certificates and "issuing" them to the investors were to devolve upon the trustee. This would seem to be a further indication of the subordination of the investment purposes of the plan to its use as an instrument for sales. This conclusion is further fortified by the fact that the purely ministerial duties involved in the plan may have been performed by a custodian or depository. In fact, in one of the earliest installment plans, Share Certificates of Financial Independence Founders, Inc., the original indenture between the sponsor and the trustee, Empire Trust Company, was captioned "De-

¹⁰² Compare the following advertisement of Independence Fund of North America, Inc. (Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 605.

Constructive Thrift

Independence Fund offers a definite, protected financial program that includes the investment of your monthly payments (\$10 or more) by an old, Conservative Trust Company acting as your trustee according to the terms of your Trust Certificate. Earnings are automatically reinvested—thus compounding them. The free booklet, "35 Questions—36 Answers," gives full details of this unique program. Send for it.

Another example is the following excerpt from a circular issued by North American Securities Company (reply to the Commission's questionnaire for Commonwealth Fund Trust Certificates, Exhibit K-2).

TRUSTEESHIP

The Trustee under Commonwealth Fund Trust Certificates is Title Insurance and Guaranty Company. Trusteeship provides the Trustor maximum protection with respect to the custody of Deposited Property.

The Trustee is authorized under the Bank Act of California to carry on a trust business, and operates under the continuous supervision of the State Banking authorities.

The company and its predecessors have been in business since 1848 under the management of the original founders and their descendants, who are substantial owners and active officers of the company. It has an unquestioned reputation and standing as a conservative and long-established institution.

Official records confirm the uniform safety as to the custody of Trust and Estate Funds committed to the care of Trust Companies, a record not exceeded by any other type of institution.

¹⁰³ Public Examination, Income Foundation, Inc., at 11692-3.

posit Agreement." The trust company was designated "Depository" and the certificate holders' fund "Deposited Property." Highly significant is the fact that five months later, a "Trust Agreement" was entered into by the sponsor and the trust company under which the "Depository" became "Trustee" and the "Deposited Property" became "Trusted Property." Hugh J. Reilly, an officer of the sponsor company, described the change as follows:¹⁰⁴

Q. When was the next situation?

A. The successive step after the deposit agreement was turned into the trust agreement with Empire Trust Company, and under that type of agreement the same trustee property, the trust shares, was used, but it moved from the custodian department of the Empire Trust Company into their trust department, and under that system the sponsor, Financial Independence Founders, still continued in the same fashion to receive the deposits and to have monthly audits prepared and delivered to the Empire Trust Company describing the cash received and its proper application as to fees and deductions of all types, and net proceeds remaining for investment, and the number of shares which should be conveyed into that trust maintained by the Empire Trust Company.

Q. To whom were payments made?

A. The payments still came to Financial Independence Founders.

He conceded that the transfer of the installment plan securities from one safety deposit box to another was the only essential change effectuated:¹⁰⁵

Q. I see. Well, now, what additional obligations were assumed by the Empire Trust Company?

A. In essence, the only change was the moving of the trust property, so-called, under the trust agreement, into the trust department of the Empire Trust Company, where formerly it was held in the custodian department of the Empire Trust Company.

Q. You mean their safety deposit box?

A. Yes.

The actual importance of the trustee's position in the plan may thus be contrasted with its usefulness to the sponsor in sales presentation. In one instance, a sponsor, Income Foundation, Inc., devised a plan that utilized several trustees giving the investor the option to select a trustee with which he was familiar. Mr. Barton, president of Income Foundation, Inc., stated that the localization of the trustee was a convenience to investors and that it made it easier to sell the plan:¹⁰⁶

Q. Why did you use two trustees?

A. As explained under our original contracts, it was to give the people living north of Maryland the right, if they so desired, to have a trustee closer to their homes. The same thing for the south.

Q. Wasn't it that it is more easy to sell a certificate for a person, for example, residing in Philadelphia, where you have a trustee, to go to him and say, "Here is this large trust company right here, your own home trustee?"

¹⁰⁴ Public Examination, Financial Independence Founders, Inc., at 6368-9.

¹⁰⁵ Id., at 6369.

¹⁰⁶ Public Examination, Income Foundation, Inc., at 11629-30.

In other words, wasn't it a selling point more than the fact that the people would like a trustee at home?

A. It is a difficult thing to answer that question. If you had asked me to express my personal opinion, it naturally made it easier to sell, but to say that the trustee was utilized generally as the big selling argument, it was not the idea of the sponsors that they should be so used.

Q. Don't you know as a matter of fact that these salesmen do use the trustee in that way?

A. I do know, as a matter of fact, that it is done in a number of cases.

The concept of "trusteeship" and the identity of the "trustee" institution were often used in the structure and the sales literature of the installment plan for promotional activities despite the inappropriateness of the description and the existence of elaborate exoneration clauses. Mr. Barton admitted that the mere use of the term "trustee" aided in the sale of the installment plan certificates,¹⁰⁷ and he agreed that the term "trustee" was inaccurate:¹⁰⁸

Q. Mr. Barton, with reference to the trust agreement, which is Commission's Exhibit 1143, is it correct to say that the duties imposed by the instrument on the trustee were purely mechanical, and vested in the trustee no discretionary powers?

A. That is correct.

Q. Isn't the term trustee rather loosely used there? Wouldn't custodian be more appropriate?

A. I agree with you, under that agreement it is rather loosely used, but on the other hand, there are a great many trust agreements created under which the trustee has very little discretion.

The effect of the "trustee" feature of the plan on many certificate holders is incontrovertible. Certificate holders believed that the trustee had something to do with the operation of the plan or was "behind" or "in back of" the plan. The oral sales presentation by representatives of the sponsor companies increased this misunderstanding of certificate holders. Salesmen took advantage of the prominence of the trustee and the status of the trustee in the plan to influence the prospective subscriber.¹⁰⁹

In the case of *Deckert v. Independence Shares Corporation*,¹¹⁰ the court concluded:¹¹¹

(6) That purchasers were told the Pennsylvania Company, &c. was the "backer" of the contract certificates.

¹⁰⁷ Id., at 11595.

¹⁰⁸ Id., at 11594-5.

¹⁰⁹ In *Deckert v. Independence Shares Corporation* (op. cit. supra, note 14), the court stated (p. 16): "Another witness, Cosmo Balanos, testified (page 275, notes of testimony) that he was employed as a salesman by Capital Savings Plan, Inc.; that the company supplied him with a 'sales kit,' on the first page of which was a photograph of the doors of The Pennsylvania Company, &c.; that on the inside was a financial statement of The Pennsylvania Company, &c.; that next appeared a letter from a vice president of The Pennsylvania Company, &c."

¹¹⁰ Op. cit. supra, note 14.

¹¹¹ Id., at 12-13.

(7) That purchasers were told that the Pennsylvania Company, &c. "guaranteed" \$2,000 for every \$1,200 paid in over a ten-year period at the end of ten years.

* * * * *

(9) That purchasers were told the Pennsylvania Company, &c. was in sole and complete control of the "investment" of funds paid in by the contract plan purchasers.

The following testimony of a certificate holder, cited by the court in *Deckert v. Independence Shares Corporation*, illustrates this point and indicates the reliance placed upon the trustee by the investor in judging the merits of the plan:¹¹²

He [the salesman] told me the Pennsylvania Company were trustees for this plan, that it positively could not go wrong because the Pennsylvania Company were backing them up in every way, shape, and form.

* * * * *

I can't tell you everything he told me, because he talked very nearly an hour, but he did make it very clear to me that the Pennsylvania Company were the trustees for this affair. I was very much impressed by it being the Pennsylvania Company because at that time I had a trust fund there, which I still have, and that was the inducement of my taking these shares, because of the Pennsylvania Company * * *. He told me at the end of ten years after depositing \$1,200 with the Capital Savings Fund that I was to get \$2,000.

According to certificate holders of another plan:

If it had not been for his telling me that the "Pennsylvania Company" was trustee, I would never have gone into the plan, because I had great confidence in the "Pennsylvania Company" and felt that the "Pennsylvania Company" was on the up and up.¹¹³

[The salesman] also told me that the Pennsylvania Company, the Trustee, was one of the oldest banks in the United States, and that it controlled most of the investments in the United States, and that therefore the money I would deposit with the said Pennsylvania Company under my Benjamin Franklin Foundation Trust Certificate, above mentioned, would be safe and always available to me no matter what might happen to Benjamin Franklin Foundation, Inc. In other words, I was led to believe that the Pennsylvania Company was behind and guaranteed my Benjamin Franklin Foundation Trust Certificate.¹¹⁴

The two representatives of Benjamin Franklin Foundation, Inc., above mentioned, did not advise me who would buy the stock but they told me and gave me the impression that it was The Pennsylvania Company for Insurances on Lives and Granting Annuities that was backing the Benjamin Franklin Foundation, Inc. In particular, the second representative of Benjamin Franklin Foundation, Inc., said "check up on the Pennsylvania Company, see who they are. You must have heard of the Pennsylvania Company, check up on them," and he tried to give me the impression that the Pennsylvania Company was guaranteeing the Benjamin Franklin Foundation, Inc., which I found out later was not true."¹¹⁵

¹¹² Id., at 14.

¹¹³ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc., et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavit of Ferdinand W. Nyemetz, sworn to January 24, 1938, at 5-6.

¹¹⁴ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc. et al.*, United States District Court for the District of New Jersey, In Equity No. E-5877, affidavit of Alice Wurzbacher, sworn to January 21, 1938, at 4.

¹¹⁵ Id., affidavit of Alexander Roon, sworn to January 25, 1938, at 4.

The trust company itself was not unmindful of the possibilities for abuse by reason of the status of the trustee in the plan. Mr. Thomas testified:¹¹⁶

Q. Now, I want to introduce in evidence this "Pyramid" No. 15, to which I call your attention, Mr. Thomas. Will you identify that?

A. Yes, sir.

Q. And I ask you whether that does not emphasize the stability of the age and the name of the Pennsylvania Company?

A. There is no question about it, and we got the devil for it, too.

While the trustee may have been aware of the potentialities of abuse in the installment investment plan by virtue of the mere presence of the trustee in the plan, no effective measures seem to have been taken to safeguard investors from being misled or confused on this point in most plans offered to the public. Recently, several sponsors have altered the terminology in their plans from "trusteeship" to "custodianship."¹¹⁷

5. "Maturity Value" or "Termination Value"

The plan or certificate almost invariably called for a certain number of specified payments. However, the use of the term "maturity" to designate the termination of the period of payment or the total amount of all the installment payments called for by the certificate, increased the susceptibility of the plan to misunderstanding and mistaken impressions. This was particularly true when the term "maturity" was applied to a definite value to be attained by the account of a certificate holder, since the value of the certificate or the amount to which the holder would be entitled upon completion of the required payment depended upon the market value of the portfolio securities underlying the certificate. The investor is entitled at all times only to the market value of his interest in the fund, which depends upon the market price of the portfolio securities in the fund. This redemption, withdrawal, or termination value is not specified, fixed, or certain. This value may be less than, equal to, or greater than the amount paid in by the investor, depending upon the market fluctuations in the prices of the underlying portfolio securities. The use in connection with installment certificates of the term "maturity" or "maturity value," in the sense that these terms are used in promissory notes or other fixed obligations is, therefore, definitely misleading.

¹¹⁶ Public Examination, Financial Independence Founders, Inc., at 6434-5.

¹¹⁷ For example, see Securities Registration Statement for Benjamin Franklin Corporation (formerly Benjamin Franklin Foundation, Inc.), File No. 2-3550, filed with the Securities and Exchange Commission May 27, 1938; Securities Registration Statement for The F-1-F Plan Corporation (formerly Financial Independence Founders, Inc.), File No. 2-3594 filed with the Securities and Exchange Commission February 1, 1938, Post-effective Amendment March 22, 1939; Securities Registration Statement for Independence Shares Corporation (merged with Capital Savings Plan, Inc.), File No. 2-3679, filed with the Securities and Exchange Commission May 19, 1938; Securities Registration Statement for Income Estates of America, Inc., File No. 2-3687, filed with the Securities and Exchange Commission May 6, 1938.

In the Matter of Income Estates of America, Inc.,¹¹⁸ the Commission, in suspending the effectiveness of a registration statement filed for an installment investment plan, passed upon the use of the term "maturity value," among other matters. The opinion of the Commission stated:

A number of deficiencies arise from the fact that two types of periodic investment plan certificates (Plan C and Plan CN) are on their face and in the prospectus expressed to have a "maturity value" of \$2,000 for each \$1.200 agreed to be paid in periodic installments by the investor.

The term "maturity value" normally refers to a fixed obligation payable at a determinable time in the future, and this meaning has been established through long usage in connection with bonds, notes, insurance policies, and similar evidences of indebtedness, where the phrase "maturity value" refers to the amount which will be owing to the investor upon the "maturity" of the instrument. Bouvier's Law Dictionary (Rawles, 3rd Revision), defines "maturity" as follows:

"In its application to bonds and other similar instruments, maturity applies to the time fixed for their payment which is the termination of the period they have to run."

Similarly, the American Institute of Accountants defines "maturity," in *Accounting Terminology* (1931), to mean, "The date on which any obligation becomes payable * * *," and *Webster's New International Dictionary* (1933) defines "maturity" as the "termination of the period a note or other obligations has to run." See also *Ardmore State Bank v. Lee*, 61 Okla. 169, 159 Pac. 903 (1916).

Typical passages in which the terms "maturity value" or "maturity" have been used in the prospectus, in order, follow:

"Trusteed Income Estate Certificates, Plan C, are issued in denominations providing for *maturity values* of \$2,000 and upward."

"Income Estates of America, Inc., agrees to notify you as soon as the value of your account reaches \$2,000 per \$10 per month payment. Your plan then *matures* and you may elect any of the *maturity* options which are later described."

"*Maturity* may be reached before or after the expiration of the ten-year period. However, if you have made your 120 deposits and your plan has not *matured* your payments cease, *maturity* then being attained by the further compounding of the earnings and appreciation in the value of the securities held for your account."

"If you elect to make 180 monthly deposits of \$10 each, the *maturity value* automatically increases to \$4,000." [Italics have been supplied.]

The term "maturity value" also appears in perhaps a dozen other passages, which we need not now quote. But nowhere in the prospectus is there a clear statement of the fact which appears from a careful reading of the certificate, that the so-called \$2,000 maturity value of the certificate is the sum which the investor may obtain only when, as, and if the value of the underlying Trusteed Industry Shares purchased with the funds paid in, less charges and deductions, has reached \$2,000. The figure is purely arbitrary. It might just as well

¹¹⁸ 2 S. E. C. 434, at 438-441 (1937). The Commission had before it two registration statements. A stop order was issued covering one and the proceedings were dismissed concerning the other. Amendments were filed curing the deficiencies of both statements but, in the public interest, were disregarded in the former instance.

have been set at \$1,000 or \$3,000, for depending upon the market value of the underlying securities it will be reached only at some indefinite time in the future, or, because of the possibility that there may be no appreciation in the market value of such securities, it may never be reached. Indeed, by virtue of the substantial charges and deductions, the total of \$1,200 paid in by the investor is reduced to about \$1,000, with the result that the attainment of the \$2,000 "maturity value" requires a total appreciation of about one hundred percent on the market value of the underlying securities. In no event does the investor have any assurance of the amount which he will receive from his investment. The fact that a maturity value has been ascribed to his certificate in no way affects the investor's substantive rights under the certificate.

The registrant cannot be heard to claim that it intended to use the phrase "maturity value" throughout the prospectus only in the artificial sense in which it is used in the certificates. Since the figure \$2,000 is a figure dependent entirely upon the market value of the underlying securities, the achievement of such value, as we have pointed out, involves an element of large contingency. To refer to the event of maturity only in phrases such as notice *as soon as* maturity is reached, or to state that "maturity may be reached *before or after* the expiration of the ten-year period," ignores entirely this essential element of contingency, for notice will be given only *if* maturity is reached, and maturity may *never* be reached.

Apart from such specifically inaccurate passages, the prospectus evidences a unified endeavor to distract the attention of the reader by importing to the concept of "maturity value" a specious reality. For example, the "maturity value" serves as the basis of calculation of registrant's service charge, which is correctly stated to be "3.6% of the *maturity value* or \$72 per \$2,000 *maturity value*." [Italics are supplied.] The reader of a precise percentile figure, carried out even beyond the decimal point, is invited by the very precision of the expression to assume that the basis of the reference possesses some significance. Again, one of the passages above quoted speaks of "maturity options" * * * and it will be observed that only one of the seven options mentioned is conditioned upon maturity; none of the others turns upon maturity at all. It is true that they may be exercised at maturity, but they may also be exercised before or after maturity. To refer to them as "maturity options" is undoubtedly a misrepresentation, but its misleading effect lies less in the misdescription of the detailed options than in the fact that lumping the options together as "maturity options" has the effect of supplying to the term "maturity" an aura of significance which it lacks, even in the special sense in which the term is used in the prospectus.

* * * * *

There appears to be no substantive or structural necessity for the use of the term "maturity value." The fact that it is mere surplusage is moreover evidenced by the fact that the fully paid certificates (Plan CP) do not employ the term "maturity value," and further from the fact that by a few simple omission on the face of the other two types of certificates, in amendments filed during the present proceedings, all mention of the term "maturity value" and all but one reference to the figure \$2,000 have been deleted without thereby varying in the slightest the contract between registrant, the trustee, and the investor. Registrant's own redrafting thus demonstrates that the term can be omitted without substitution of any other term and with no compensating changes in the remaining phrasing of the instruments.

6. Insurance and Loan Provisions

Various features of the installment investment plan were included as part of the structure or terms of the plan, apparently because of their sales appeal to the investor and not because they served a vital investment purpose. The insurance feature evidently was such a provision.

Concerning this aspect of the installment plan, Mr. Thomas testified:¹¹⁹

Q. You also emphasize the insurance plan, and that helps you to sell these plans, doesn't it?

A. That is right.

Q. That is nothing more than an ordinary term insurance, is it? I mean, it is at a rate anybody can get, isn't it?

A. I don't think people 50 years old can get term insurance for \$8.50 a thousand. Do you?

Q. I don't think so.

A. No.

Q. No; they can not.

A. The insurance factor, the insurance feature, if people want it, is a beneficial thing.

Q. It is a powerful sales weapon, isn't it?

A. Well, I wouldn't say that. We sell more plans without the insurance than we do with the insurance.

Q. It [a publication issued to salesmen by the sponsor] says: "This new low rate will considerably strengthen this already powerful sales weapon."

A. The results are that we sell more plans without the insurance than we do with it.

Q. I am quoting your own language.

The presence of an insurance provision in the installment plan rendered the plan susceptible to misunderstanding by certificate holders and to misrepresentation by salesmen, as has been pointed out previously. Moreover, the premiums for insurance were generally deducted from payments made by certificate holders and, consequently the net amount invested in underlying securities was less and the percentage of the total loading charge on the net amount invested was greater than in the case of plans without insurance. Thus the investor was paying more in fees in relation to what was invested for him.

Loan provisions of the installment plan were another feature stressed by sponsors because of the sales appeal of such provisions. However while it was impressed upon the certificate holder that he could borrow the greater portion of his investment in the installment plan, the distinction between the availability of his net investment depending upon the value of fluctuating common stocks and the amount of the payments that he had made, was not always clearly pointed out. The confusion possible as a result of not making this distinction clear led to misrepresentations by sales personnel and in sales literature as to the "borrowing privilege" under the installment investment plan, as has already been pointed out.

¹¹⁹ Public Examination, Financial Independence Founders, Inc., at 6441.

Chapter VI

EXPERIENCE OF CERTIFICATE HOLDERS IN INSTALLMENT PLANS, 1930-1937

The experience of certificate holders as a group in installment investment plans from 1930, when the first plans made their appearance, to December 31, 1937, was marked by heavy realized and unrealized losses.¹ During this period certificate holders of 33 plans for which detailed data through 1937 are available, and which represent almost the entire industry, made payments aggregating \$52,553,000.² Repayments upon withdrawal and dividends distributed to certificate holders amounted to \$10,199,000. Out of the balance of \$42,354,000, representing the net capital investment at the end of 1937, there remained only \$25,136,000 of net assets in these plans. Thus, a realized and unrealized net loss of \$17,218,000, or approximately 33% of the total payments of certificate holders, was suffered by investors in these plans.³

This loss of \$17,218,000 was largely due to fees, loads, and charges levied upon the funds of certificate holders. Sponsors' primary loads and trustees' fees alone amounted to \$9,765,000. Net insurance costs were \$873,700. Realized and unrealized depreciation, which includes secondary loading charges, related charges and hidden loads, amounted to \$9,593,000. These items of loss, totaling \$20,232,000, were partially offset by net income of \$3,015,000 earned on the underlying securities and reinvested for certificate holders, resulting in the net loss of \$17,218,000.⁴

The following schedule is a summary of the experience of certificate holders derived from the detailed composite statements of assets

¹ The data for the composite statements presented in this section cover one plan operating in 1930, 7 plans in 1931, 14 plans in 1932, 18 plans in 1933, 19 plans in 1934, 29 plans in 1935, 32 plans in 1936, and 31 plans in 1937. The operations indicated were continuous from the inception of each plan to the end of the period (except for two plans which were excluded in 1937 for lack of data). These plans cover the great bulk of the installment plan industry—estimated at over 90%. The figures were obtained from replies to the Commission's questionnaire for the period from 1930 to 1935 and from supplemental information made available to the Commission through 1937. Some information was also derived from securities registration statements filed with the Commission.

² This amount includes \$967,338 paid for insurance premiums. In general, this represents a cost for insurance and not for investment and should be considered separately from the load for investment. However, since it was a cost borne by investors in connection with the plans, and since the proceeds of insurance on the death of certificate holders were invested as other payments, it has been included in these tables although considered separately.

³ This loss includes net insurance cost of \$873,697, which was the amount of insurance premiums paid less proceeds obtained from insurance on the lives of deceased certificate holders.

⁴ The loss suffered by withdrawing certificate holders is a realized loss which is contained in the net loss of \$17,218,000 shown above for all certificate holders. The extent of the loss sustained by withdrawing certificate holders is not determinable on the basis of the data submitted by the sponsor companies to the Commission. For the experience of certificate holders in 11 plans up to the end of 1935, however, see Tables 10 and 11, *supra*.

and liabilities and of receipts and dispositions of the funds of certificate holders for these plans, contained in the appendixes: ⁵

*Summary of certificate holders' experience in installment investment plans
(1930-37)*

1. Payments made by certificate holders-----	\$52, 553, 244
2. Returned to certificate holders:	
Dividends -----	\$634, 182
Repayments on withdrawal-----	9, 565, 353
Total-----	10, 199, 535
3. Net investment of certificate holders at December 31, 1937-----	42, 353, 709
4. Net assets at market remaining for certificate holders at December 31, 1937-----	25, 136, 068
5. Net loss to investors (3-4)-----	17, 217, 641
Loss accounted for as follows:	
Sponsors' primary loads and trustees' fees---	9, 765, 464
Net insurance cost-----	873, 697
Realized and unrealized depreciation of assets-----	^a 9, 593, 207
Total-----	20, 232, 368
Less net income on trust property-----	3, 014, 727
Loss -----	17, 217, 641

^a This figure includes secondary loading charges, related charges, and hidden loads. See Ch. IV, Sec. A, 2, *supra*.

The experience of investors as a group for each year in the 33 installment investment plans considered above is shown in detail in Appendix I. A summary analysis of this year by year experience is presented in Table 16.

TABLE 16.—*Summary of investors' experience in 33 installment investment plans by years, 1930-37*

Year ending Dec. 31	Num- of plans	Total invest- ment	Apprecia- tion (deprecia- tion) of assets ^a	Sponsors' primary load and trustees' fees ^b	Net income on trust property	Net gain (loss) to investors	Percent of net gain (loss) to total investment
1930-----	2	\$157, 690	\$(16, 607)	\$82, 899	\$7, 397	\$(92, 109)	(58. 4)
1931-----	7	1, 043, 949	(224, 042)	507, 508	32, 509	(699, 041)	(63. 0)
1932-----	14	2, 141, 886	(348, 168)	738, 336	217, 335	(869, 169)	(34. 2)
1933-----	18	3, 056, 658	700, 607	701, 719	190, 785	189, 673	4. 1
1934-----	19	4, 421, 719	(742, 950)	906, 268	171, 383	(1, 477, 835)	(18. 0)
1935-----	29	7, 217, 972	2, 312, 860	1, 222, 358	334, 168	1, 424, 670	10. 9
1936-----	32	14, 853, 019	2, 314, 108	2, 565, 644	786, 064	534, 528	1. 9
1937-----	31	19, 660, 351	(13, 589, 015)	3, 914, 429	1, 275, 086	(16, 228, 358)	(37. 2)
Total-----	33	52, 553, 244	(9, 593, 207)	10, 639, 161	3, 014, 727	(17, 217, 641)	(32. 8)

^a Represents net realized and unrealized appreciation or depreciation of trust assets at end of year over assets at beginning of year plus additions.

^b Includes net insurance costs aggregating \$873,697.

⁵ See Appendixes F, G, and H.

The most serious loss (\$16,228,000) was sustained in 1937. Losses also occurred in 1930, 1931, 1932, and 1934. The net gains in 1933, 1935, and 1936 were comparatively slight. While fluctuations in market price accounted for a part of the loss or gain in each year, the substantial and constant handicap to successful performance because of sponsors' loads and trustees' fees is apparent.⁶ Secondary loading charges, charges in connection with the purchase, sale, and management of underlying securities, and hidden loads were not segregated in the data submitted to the Commission and are represented in the residual item termed "realized and unrealized depreciation of assets." The amount of total fees and charges is thus considerably more for each year than is shown in the table under the item for sponsors' primary loads and trustees' fees.

For the various years in which the installment investment plans operated up to the end of 1937, their performance year by year, after deducting sponsors' primary loads, trustees' fees, and insurance costs, is shown in Table 17:⁷

TABLE 17.—*Summary of performance of 33 installment investment plans by years, 1930-37*

Year ending Dec. 31	Number of plans	Net assets at beginning of year plus net additions during year	Net assets at end of year	Realized and unrealized appreciation (depreciation) at end of year	Percentage of appreciation (depreciation) to net assets at beginning plus net additions
1930.....	2	\$82,188	\$65,581	\$(16,607)	(20.2)
1931.....	7	627,146	403,104	(224,042)	(35.7)
1932.....	14	1,969,274	1,621,106	(348,168)	(17.7)
1933.....	18	3,082,483	3,783,090	700,607	22.7
1934.....	19	6,653,829	5,910,879	(742,950)	(11.2)
1935.....	29	10,760,014	13,072,874	2,312,860	21.5
1936.....	32	22,461,161	24,775,269	2,314,108	10.3
1937.....	31	37,952,254	24,363,239	(13,589,015)	(35.8)
1930-37.....	33	34,729,275	25,135,068	(9,593,207)	(27.6)

This table affords some indication of the market appreciation or depreciation of certificate holders' funds during the period from 1930 to 1937 although secondary loading charges, related loads and hidden loads which are not determinable, are not deducted in obtaining the figures for net additions during each year. Hence the performance of the underlying securities themselves was somewhat better than is disclosed by these figures.

⁶ Service fees are generally deducted in the first year of the plan and do not recur in subsequent years. This fact, however, would not necessarily mean a reduction in the aggregate amount of service fees in the years after 1937, since it would be offset by the high rate of withdrawals and the number of new sales. While the amount of service fees as a percentage of the net investment decreased from 1930 to 1935, from 1935 to 1937 it increased.

⁷ This table is a summary of Appendix H.

Cumulatively, certificate holders as a group experienced a loss throughout the entire period.⁸ A summary of the cumulative experience of certificate holders is presented in Table 18.

TABLE 18.—Summary of cumulative experience of investors in 33 installment investment plans, 1930–37

Jan. 1, 1930, through Dec. 31—	Total investment	Cumulative net loss of investors	Percent of net loss to total investment
1930.....	\$157,690	\$92,109	58.4
1931.....	1,201,639	791,150	65.8
1932.....	3,343,525	1,660,319	49.7
1933.....	6,400,183	1,470,646	23
1934.....	10,821,902	2,948,481	27.2
1935.....	18,039,874	1,523,811	8.4
1936.....	32,892,893	989,283	3
1937.....	52,553,244	17,217,641	32.8

By the end of 1934 investors in installment plans had sustained a net loss of almost \$3,000,000, amounting to over 27% of their total investment up to that time. The net yearly gains in the market value of the underlying securities of the plans in 1935 and 1936 were insufficient to overcome the cumulative loss suffered by investors during the earlier years. The sharp decline in the market value of portfolio securities in 1937, plus heavy fees, loads, and charges, brought the net loss for the period, as indicated above, to \$17,218,000.

The decline in market value of the securities underlying the installment-plan certificates accounted for less than half of the realized and unrealized losses sustained by certificate holders. Fees, loads, charges, and other costs accounted for the balance. Even in the years 1935 and 1936, when the value of underlying securities appreciated 21.5% and 10.3%, respectively, after four years of continued rise in security prices, the value of the certificate holders' interest was 8.4% and 3.0%, respectively, less than their actual contributions up to these dates. Apparently the cost of participating in the installment investment plan (the loading charges) proved to be a handicap too great to overcome even after prosperous years.

In justification of the creation of the installment investment plan the sponsors have stated that the plan has the advantage of placing a constant pressure on the certificate holder to make regular payments, and that this persuasion to make periodic investments was a form of "semicompulsory savings." When examined as to the service rendered by the sponsor company for its "service fee," Mr. Barton testified:⁹

Q. What service do you feel you render to these investors in return for the 17-percent load, outside of insurance?

A. There are two services that we render them, primarily. In the first service, we enable them to purchase securities which you may say they could

⁸ See Appendix J. This table shows the annual experience of investors from 1930 to 1937 on a cumulative basis.

⁹ Public Examination, Income Foundation, Inc., at 11612.

purchase themselves, trust shares. They can't purchase fractional shares. They have no definite, specific plan. This gives them a definite, specific plan, and I think history has proven that without a specific, definite plan, which in most cases must be semicompulsory, the average man won't follow it.

Edward T. Clark, of Benjamin Franklin Foundation, Inc., testified to the same effect.¹⁰

* * * but, nevertheless, our plan offers him an incentive in the monthly reminder sent out by the trustee and return envelope, and a point that I am particularly anxious to emphasize is a semicompulsory feature—in that he cannot withdraw all of his funds immediately or at his whim—without suffering some monetary loss, at least for the early stages of the plan. In other words, it is our firm conviction that that one feature of the plan is one of the strongest and most beneficial features, regardless of the fact that deductions are made for the purposes of paying sales commissions and so forth; that that one element supplies the semicompulsory feature which is necessary to inspire and assist the individual in completing his program once he has started it, and we base that belief on a study of voluntary savings plans; for example, savings funds, whose records will indicate that the average life of a savings fund is about eighteen months. When he has accumulated about \$1,800, he draws it out. If it were impossible for him to walk in and draw out all that money, he wouldn't be quite so ready to do it.

Considering the high rate of lapses of certificate holders, particularly in the first few months of the plan,¹¹ it is questionable whether the sponsor's "pressure" on the certificate holders to make payments has been efficacious. Apparently the \$10-a-month investor found difficulty in continuing payments, despite the efforts of the sponsor.

Admittedly the plans were intended to reach the type of investor who could only afford to make payments of \$10 a month.¹² In view of the various defects and problems pointed out as prevalent in this type of investment medium and in view of the actual experience of investors, it is questionable whether the installment investment plan, as presently constituted, operated, and maintained, involving the purchase of fluctuating common stock through the means of a "trust on a trust" with high selling costs, maintenance fees, other loads, and the duplication of expenses, fills an "economic need" for these classes of individuals.

¹⁰ Hearings *In the Matter of Benjamin Franklin Foundations, Inc.*, held on December 23, 1937, pursuant to order for investigation dated November 23, 1937, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, at 29–30.

¹¹ See Chart 4, *supra*.

¹² See Ch. IV, Sec. B, *supra*. Cf. the following excerpt from an advertisement of Independence Fund of North America, Inc. (Public Examination, Independence Fund of North America, Inc., Commission's Exhibit No. 605, 6–F): "Today—even on a small salary—you can set up a trusteeship estate like those hitherto available only to wealthy persons. This is addressed to people who have their salary or wages—and nothing more—and who are thinking about their financial future."

Appendix A

SPONSORS AND TRUSTEES OF INSTALLMENT INVESTMENT PLANS

Name of sponsor	Name of plan	Trustee	Year of indenture
American Participations, Inc.	American Participations Certificates.	City National Bank & Trust Co., Kansas City, Mo.	1932
Assured Income Builders, Inc.	Assured Income Builders, Inc., Investment Plan.	Trust Company of North America, New York, N. Y.	1931
Benjamin Franklin Foundation, Inc.	Benjamin Franklin Foundation Trust Certificates.	Pennsylvania Company for Insurances on Lives and Granting Annuities, Philadelphia, Pa.	1935
Capital Savings Plan, Inc.	Capital Savings Plan Contract Certificates.	Pennsylvania Company, etc., Philadelphia, Pa.	1931
Corporate Equities, Inc.	Trust Endowment Agreements.	First National Bank of Jersey City, Jersey City, N. J. (Harriman National Bank & Trust Co., New York, N. Y., predecessor, 1932-33).	1933
Do	Trust Endowment Agreements, Type B.	First National Bank of Jersey City, Jersey City, N. J.	1935
Corporate Leaders of America, Inc.	Corporate Leaders Trust Certificates.	Continental Bank & Trust Co., New York, N. Y. (Charleston National Bank, Charleston, W. Va., predecessor, 1931-33).	1933
Do	Corporate Leaders Trust Fund Certificates, Series A.	Empire Trust Co., New York, N. Y.	1935
Euclid Investors, Inc.	Euclid Investment Trust Certificates.	Central Trust Co., Lansing, Mich. (Fidelity Bank & Trust Co., of Detroit, Detroit, Mich., predecessor, 1930-31).	1931
Financial Independence Founders, Inc.	Financial Independence Founders' Share Certificates, Deposit Series.	Empire Trust Co., New York, N. Y. (custodian).	1930
Do	Financial Independence Founders' Share Certificates, T Series.	Empire Trust Co., New York, N. Y.	1930
Do	Financial Independence Founders' Share Certificates, Q Series.	Pennsylvania Company, etc., Philadelphia, Pa.	1931
Do	Financial Independence Founders' Trustee Certificates, D Series.	do	1932
Financial Security Fund, Inc.	Financial Security Fund Plan.	Trust Company of New Jersey, Jersey City, N. J. (custodian).	1935
Foundation Plan, Inc.	Foundation Plan, Inc., Endowment Certificates.	Commercial National Bank & Trust Co., New York, N. Y.	1935
Fundamerican Corporation.	Fundamerican Trusteed Certificates.	Manufacturers' Trust Co., New York, N. Y.	1933
General Reserves Corporation.	General Reserves Corporation Trust Fund Certificates, Series A.	Industrial Trust Co., Wilmington, Del.	1936
Hamilton Depositors' Corporation.	Hamilton Trust Shares Certificates.	International Trust Co., Denver, Colo. (Guardian Trust Co., Denver, Colo., predecessor, 1931-34).	1934

Sponsors and Trustees of Installment Investment Plans—Continued

Name of sponsor	Name of plan	Trustee	Year of indenture
Income Estates of America, Inc.	Trusteed Income Estates Certificates, Original Series.	Pennsylvania Company, etc., Philadelphia, Pa.	1933
Do.....	Trusteed Income Estates Certificates, Series C.	do.....	1935
Income Foundation Fund, Inc.	Income Foundation Fund Agreements and Certificates of Trust.	(1) Pennsylvania Company, etc., Philadelphia, Pa., and (2) Equitable Trust Co., Baltimore, Md.	1934 1934
Income Foundation, Inc.....	Income Foundation Investment Contracts, Plans A, B, and C.	Union Trust Co. of Maryland, Baltimore, Md.	1931
Do.....	Income Foundation Investment Contracts, Plans D and E.	(1) Pennsylvania Company, etc., Philadelphia, Pa., and (2) Equitable Trust Co., Baltimore, Md. (Union Trust Co., Baltimore, Md., predecessor to Equitable Trust Co., 1932-33).	1932 1933
Do.....	Income Foundation Investment Contracts, Plans F and G.	(1) Pennsylvania Company etc., Philadelphia, Pa., and (2) Equitable Trust Co., Baltimore, Md. (Union Trust Co., Baltimore, Md., predecessor to Equitable Trust Co., 1932-33).	1932 1933
Independence Fund of North America, Inc.	Independence Fund Participation Agreements.	City Bank Farmers' Trust Co., New York, N. Y. (Empire Trust Co. and Bank of America National Association, New York, N. Y., predecessors, 1930-31).	1931
Do.....	Independence Fund Trust Certificates.	Empire Trust Co., New York, N. Y. (City Bank Farmers Trust Co., New York, N. Y., predecessor, 1931-34).	1934
Do.....	Independence Fund Declarations of Trust and Agreement.	Empire Trust Co., New York, N. Y.	1935
Do.....	Independence Fund Declarations of Trust.	do.....	1935
Individual Assured Estates, Inc.	Individual Assured Estates, Inc., Endowment Trust Certificates.	Title Insurance and Guaranty Co., San Francisco, Calif.	1933
Insured Investors, Inc.....	Insured Investors, Series A Certificates.	Commerce Trust Co., Kansas City, Mo.	1932
Do.....	Insured Investors, Series B Certificates.	do.....	1935
International Depositors Corporation.	International Investment Trust Units.	Guardian Trust Co., Denver, Colo.	1931
Investors Independence Corporation.	Investors Independence Trust Share Certificates.	Colorado National Bank, Denver, Colo.	1932
Lexington Foundation, Inc..	Future Requirements Plan Investment Certificates, FA and FB.	Pennsylvania Company, etc., Philadelphia, Pa. (Harriman National Bank & Trust Co., predecessor, 1932-33).	1933
Do.....	Future Requirements Plan Investment Certificates, FC and FD.	Pennsylvania Company, etc., Philadelphia, Pa.	1933
Do.....	Lexington Foundation Contract Certificates, L, LN, and LP.	do.....	1936

Sponsors and Trustees of Installment Investment Plans—Continued

Name of sponsor	Name of plan	Trustee	Year of indenture
Liberty Thrift Foundation, Inc.	Liberty Thrift Foundation Trust Certificates.	Pennsylvania Company, etc., Philadelphia, Pa.	1936
National Assured Estates, Inc.	Assured Independence Plan Trusteed Certificates.	Harriman National Bank & Trust Co., New York, N. Y.	1931
National Trustee Fund, Inc.	National Trustee Fund, Inc., Share Certificates.	City National Bank of Philadelphia, Philadelphia, Pa.	1931
Do.....	National Trustee Fund, Inc., Contract Certificates.	Pennsylvania Company, etc., Philadelphia, Pa.	1934
National Unit Corporation..	National Unit Cumulative Investment Certificates.	Peoples-Pittsburgh Trust Co., Pittsburgh, Pa.	1931
North American Bond and Share Corporation.	North American Bond and Share Bond and Participating Certificates.	Trust Company of Chicago, Chicago, Ill.	1933
North American Securities Co.	Commonwealth Fund Trust Certificates.	Title Insurance & Guaranty Co., San Francisco, Calif.	1935
Parker (C. D.) & Co., Inc...	Accumulating Investment Plan Subscription Certificates	National Shawmut Bank of Boston, Boston, Mass. (custodian).	1932
Prudential Assured Estates, Inc.	Prudential Assured Estates Trust Certificates.	Harriman National Bank & Trust Co., New York, N. Y.	1932
Selected Managements Foundation.	Selected Managements Investment Certificates.	Equitable Trust Co., Detroit, Mich.	1931
Southwest Investors, Inc....	Southwest Investors Trust Units.	Charles H. Allen (Individual trustee).	
Standard Foundations of America, Inc.	Standard Trust Foundation Agreements.	Empire Trust Co., New York N. Y.	1933
Thrift Investment Certificate Corporation.	Thrift Investment Certificates of Agreement.	Industrial Trust Co., Wilmington, Del.	1931
Transcontinent Shares Corporation.	Insured Stock Plan Contract Certificates.	Pennsylvania Company, etc., Philadelphia, Pa.	1932
Do.....	New York Bank Stock Plan Contract Certificates.	do.....	1932
Union Deposit Co.....	Union Investment Trust Certificates.	(1) Union Trust Co., Denver, Colo. (2) Metropolitan Trust Co., Los Angeles, Calif. (3) Pennsylvania Company, etc., Philadelphia, Pa. (Harriman National Bank & Trust Co., New York, N. Y., predecessor, 1932-33).	1929 1930 1933
United Endowment Foundation, Inc.	United Endowment Foundation, Inc., Endowment Certificates.	Commercial National Bank & Trust Co., New York, N. Y. (Harriman National Bank & Trust Co., New York, N. Y., predecessor, 1932-33).	1933
United Securities Co. of Missouri.	United Fund Accumulative Certificates, Series T. A.	Commerce Trust Co., Kansas City, Mo.	1935
Do.....	United Fund Income Certificates, Series T. I.	do.....	1935
Wellington Foundation, Inc.	Wellington Foundation Trust Certificates.	Pennsylvania Company, etc., Philadelphia, Pa.	1935

Appendix B

UNDERLYING SECURITIES OF INSTALLMENT INVESTMENT PLANS

Name of plan *	Underlying security	Type	Relationship of sponsor to issuer or depositor
American Participations Certificates.	Fixed portfolio of common stock.	Unit of securities type.	
Assured Income Builders, Inc., Investment Plan.	Trustee Standard Investment Shares, Series D.	Fixed trust.....	None.
Benjamin Franklin Foundation Trust Certificates.	Trusted Industry Shares...	.....do.....	Do.
Capital Savings Plan Contract Certificates.	Independence Trust Shares.	.....do.....	Depositor a subsidiary of sponsor.
Trust Endowment Agreements.	Trust Endowment Shares, Series A.	.....do.....	Sponsor and depositor the same.
Trust Endowment Agreements, Type B.	.....do.....	.....do.....	Do.
Corporate Leaders Trust Certificates.	Fixed portfolio of common stock.	Unit of securities type.	
Corporate Leaders Trust Fund Certificates, Series A.	.....do.....	Fund of securities type.	
Euclid Investment Trust Certificates.	Restricted portfolio of securities.	Fund of securities type.	
Financial Independence Founders Share Certificates, Deposit Series.	Corporate Trust Shares....	Fixed trust.....	None.
Financial Independence Founders Share Certificates, T Series.	.....do.....	.....do.....	Do.
Financial Independence Founders Share Certificates, Q Series.	.....do.....	.....do.....	Do.
Financial Independence Founders Trust Certificates, D Series.	Diversified Trustee Shares, Series D.	.....do.....	Do.
Financial Security Fund Plan.	Financial Security Fund, Inc. capital stock.	Open-end management company.	Distributor of stock and sponsor of plan the same.
Foundation Plan, Inc., Endowment Certificates.	Foundation Trust Shares, Series A.	Fixed trust.....	Sponsor a subsidiary of depositor.
Fundamerican Trustee Certificates.	Fundamental Trust Shares, Series A.	.....do.....	None.
General Reserves Corporation Trust Fund Certificates, Series A.	Unrestricted portfolio of securities with diversification requirements.	Fund of securities type.	
Hamilton Trust Shares Certificates.	Fixed portfolio of common stock.	Unit of securities type.	
Trusted Income Estates Certificates, Original Series.	Trusted Industry Shares and Trusted American Bank Shares, Series B.	Fixed trust.....	None since 1934.
Trusted Income Estates Certificates, Series C.	Trusted Industry Shares...	.....do.....	None.

* These plans are arranged alphabetically in the order of the sponsors' names.

Underlying Securities of Installment Investment Plans—Continued

Name of plan	Underlying security	Type	Relationship of sponsor to issuer or depositor
Income Foundation Fund Agreements and Certificates of Trust.	Income Foundation Fund, Inc. capital stock.	Open-end management company.	Sponsor and issuer the same.
Income Foundation Investment Contracts, Plans A, B, and C.	Independence Trust Shares.	Fixed trust.....	None.
Income Foundation Investment Contracts, Plans D and E.	Bullock Fund, Ltd., capital stock.	Open-end management company.	Do.
Income Foundation Investment Contracts, Plans F and G.	Nation-Wide Securities Co. (Md.) capital stock.	.....do.....	Do.
Independence Fund Participation Agreements.	North American Trust Shares (1953).	Fixed trust.....	Do.
Independence Fund Declarations of Trust and Agreement.	Restricted portfolio of securities.	Fund of securities type.	
Independence Fund Trust Certificates.	Cumulative Trust Shares...	Fixed trust.....	Do.
Independence Fund Declarations of Trust.	Restricted portfolio of securities.	Fund of securities type.	
Individual Assured Estates, Inc. Endowment Trust Certificates.	Foundation Trust Shares, Series A.	Fixed trust.....	Do.
Insured Investors, Series A Certificates.	Trustee Standard Investment Shares, Series D.	.....do.....	Do.
Insured Investors, Series B Certificates.	Fixed portfolio of common stock.	Unit of securities type.	
International Investment Trust Units.	Restricted portfolio of securities.	Fund of securities type.	Do.
Investors Independence Trust Share Certificates.	Independence Trust Shares.	Fixed trust.....	Do.
Future Requirements Plan Investment Certificates, FA. and FB.	.....do.....	.....do.....	Do.
Future Requirements Plan Investment Certificate, FC and FD.	{ Independence Trust Shares (1933-34) and Trusteed Industry Shares (1934-37). }	.....do.....	Do.
Lexington Foundation Contract Certificates, L, LN, and LP.	Trusteed Industry Shares...	.....do.....	Do.
Liberty Thrift Foundation Trust Certificates.	.....do.....	.....do.....	Do.
Assured Independence Plan Trusteed Certificates.	Trust Shares of America...	.....do.....	Do.
National Trustee Fund, Inc., Share Certificates.	Independence Trust Shares.	.....do.....	Do.
National Trustee Fund, Inc., Contract Certificates.	.....do.....	.....do.....	Do.
National Unit Cumulative Investment Certificates.	Portfolio of management investment company stocks. ^b	Management company stock, fund type.	Do.
North American Bond and Share Bond and Participating Certificates.	Massachusetts Investors Trust Shares.	Open-end management company.	Do.

^b The names of these companies were The Adams Express Co., American International Corporation, Tri-Continental Corporation, The United Corporation and Insuranshares Corporation of Delaware.

Underlying Securities of Installment Investment Plans—Continued

Name of plan *	Underlying security	Type	Relationship of sponsor to issuer or depositor
Commonwealth Fund Trust Certificates.	Commonwealth Investment Co. capital stock.	Open-end management company.	Distributor of stock and sponsor of plan the same.
Accumulating Investment Plan Subscription Certificates.	(Collateral Trustee Shares, Series A (1933-34), and Mutual Investment Trust (1934-35).	Fixed trust.....	Sponsor was principal distributor of trust.
Prudential Assured Estates Trust Certificates.	Trust Fund Shares.....	Open-end management company.	None.
Selected Managements Investment Certificates.	Selected Managements Trustee Shares.	Fixed trust.....	Do.
Southwest Investors Trust Units.	No information.....	.....do.....	Sponsor a subsidiary of depositor.
Standard Trust Foundation Agreements.	Trustee Standard Investment Shares, Series D.	.....do.....	None since 1935.
Thrift Investment Certificates of Agreement.	Shares of 8 fixed trusts.....	Fixed trust.....	None.
Insurance Stock Plan Contract Certificates.	Deposited Insurance Shares, Series A.	.....do.....	Sponsor and depositor the same.
New York Bank Stock Plan Contract Certificates.	Deposited Bank Shares, N. Y. Series A.	.....do.....	Do.
Union Investment Trust Certificates.	Restricted portfolio of securities.	Fund of securities type.	Do.
United Fund Accumulative Certificates, Series T. A.	.....do.....	.....do.....	
United Endowment Foundation Inc., Endowment Certificates.	Foundation Trust Shares, Series A.	Fixed trust.....	Do.
United Fund Income Certificates, Series T. I.	Restricted portfolio of securities.	Fund of securities type.	
Wellington Foundation Trust Certificates.	Wellington Fund, Inc., common stock.	Open-end management company.	Affiliated officers.

* The names of these trusts were United States Electric Light & Power Shares, Inc. Trust Certificates, Series B, Selected Cumulative Shares, Nation-Wide Securities Co. Trust Certificates, Series B, Selected Income Shares, Trustee Standard Oilshares, Series B, Corporate Trust Shares AA Modified, Diversified Trustee Shares, Series D, North American Trust Shares, 1956.

Appendix C

A SAMPLE "SALES PRESENTATION" TALK OF AN INVESTMENT PLAN SALESMAN¹

I want to submit to you an old and established plan for the profitable accumulation of money.

It has evidenced a great deal of interest on the part of the public at large and it will also interest you.

In order to illustrate the idea, let us agree on one thing, namely, That the best way to accumulate money is the sinking fund way, the common sense way.

If a business house has a future obligation to meet what do they do?

They set aside certain definite sums at certain definite times so that on the maturity of the obligation they have the money on hand to discharge it, that is a sinking fund.

A business house is desirous of accumulating money for a number of reasons, to pay off a mortgage or other indebtedness; partnership considerations group and welfare work, to retire upon, or to create depression or obsolescence account.

Inasmuch as business houses have found it so beneficial and profitable why not apply it to yourself as an individual.

An individual is also desirous of accumulating money for a number of reasons, to take a trip around the world or other cultural pursuit, a sum of money to go into business, to buy a new home or refinance a property, to pay off a mortgage, to create a retirement or pension fund, or to create an estate for loved ones or maybe you as a prospect are desirous of accumulating money to send your son or daughter to college.

In order to illustrate the idea let us assume that you would like to send your son to college and that it would cost you \$5000. to do this.

This small sum is purposely used for simplicity of illustration as it could be 10,000-25,000 or a million, the percentages, proportions and principals all remain about the same. Let us say that you can put aside 40.00 a month and to establish for yourself a medium for your sinking fund you go to a bank, one of the well established and outstanding banks in the U. S., that you go to the savings dep't., and open a savings account and if you do this for 12 months you will have accumulated 480.00, and if you do this for 10 years you will have accumulated 4,800.00 and with compounded interest at the prevalent rate of 2% you will have the money with which to send your son to college.

¹ *Securities and Exchange Commission v. Benjamin Franklin Foundation, Inc. et al.*, United States District Court for the District of New Jersey, In Equity No. E 5877, affidavit of William S. Becker, sworn to January 3, 1938, at 13-13b. This "talk" is reproduced exactly as given in the affidavit.

That is a sinking fund, the common sense way of saving money if you follow this method you will accumulate your money, if you follow this procedure your son will go to college, "If" you live to see the day.

There are a number of ways of accumulating money, saving accounts, insurance, stock market, etc., but there is only one sure way the sinking fund way.

Now we could not possibly improve on the method, the method is right, we could not improve on the procedure, the procedure is right.

The only possible suggestion we could make is the medium, instead of using the savings dep't, why not avail yourself of the trust dep't.

The only physical difference is that instead of putting your money in this window you put it in this window.

In other words, instead of opening a savings account, make use of a trust account for yourself with the Penna., Co., one of the countries greatest banking institutions as trustee under the B. F. F. plan, and if you do this you won't need 40.00 a month, in all probability 20.00 will be sufficient, and if you do this for 12 months you will have deposited for yourself 240.00 and in 120 months or 10 years you will have 2,400.00, and at the end of 10 yrs., at this maturity period it will provide you with 5,000.00, the amount of money needed to provide your son the advantage of a college education.

It was pointed out Mr. Pros., that in the case of the savings account you would have accumulated your money and your son would go to college "if" you live to see the day.

Because of the insurance division incorporated in the B. F. plan in the event of your untimely calling all uncompleted deposits are completed in their integrity so that nothing will stop you from accumulating your money, and nothing will stop your son from going to college not even death itself so therefore that if is removed.

Now Mr. Prospect if I can prove to your entire satisfaction every statement I have made either expressed or implied are you ready to avail yourself of this well established plan and if so, to what extent.

Benjamin Franklyn Foundation Plan complies with the rules of United States department of Banking & Insurance and Securities and Exchange Commission.

Appendix D

BULLETIN, "ON SELLING WOMEN," ISSUED TO SALESMEN BY INDEPENDENCE FUND OF NORTH AMERICA, INC.¹

Trust Fund Topics issued periodically by Independence Fund of North America, Inc., 1 Cedar Street, New York, N. Y.

OCTOBER 1, 1936.

The statements contained herein, while not guaranteed, are based upon information which we believe accurate and reliable.

ON SELLING WOMEN

From the cradle to the grave you have sold, and will continue to sell, women. Man, by his very nature, is continually asking of and receiving from women. Unconsciously each of us builds for himself his own especial technique in dealing with the opposite sex. It is with this thought in mind that this memorandum is prepared. I am suggesting that we can each *consciously improve* that technique, each in our own way, and increase our sales potential through a more intensive drive for women clients.

From the latest statistical information available we learn that 54% of the vested wealth of this country is either in the hands of, or controlled by, women. This situation has been brought about largely because of the fact that the life span of women is slightly longer than that of men, hence, through inheritance and insurance, women have in the past gradually acquired the control of money. This applies to all classes in the economic scale.

Despite this vast market we are not doing the job we should do. Particularly when the prospective client we are neglecting is the very type of person who most needs the services which we, of Independence Fund, have to offer. Even the most casual survey of our clients' lists would reveal the fact that but 25% are women instead of 54%, as indicated by their share of the country's wealth.

GETTING TO THE WOMAN BUYER

Volumes have been written, and additional volumes could be written, on feminine psychology. I offer here but a few pointers and suggestions which may be helpful. Women are definitely harder to "get to" than the average businessman. The average businessman type of client cannot always devote enough time and attention for a clear explanation of the advantages of Independence Fund for *Him*. Women, on the other hand, particularly women at home, are definitely harder to see, but once seen they *can* devote the time

¹ Reply to the Commission's questionnaire for Independence Fund of North America, Inc., Exhibit No. 403.

and attention that your presentation warrants. It might be well to remember that the more difficult a prospect is to reach *for you*, the more *difficult* the prospect is to reach *for your competitor*. Cold turkey rarely sells a woman. Always approach a woman through someone known to her, and whom she instinctively likes, admires, or envies. Bear in mind that woman is an intuitive animal. Her race heritage, her instinct have made her so. This phenomena is vouched for by our most eminent psychologists; be absolutely frank and sincere with her.

It should not be difficult to obtain leads to women prospects from your present clients and prospects. The ideal approach, naturally, is through personal introduction. An exceptionally favorable response can often be obtained by a telephone call from a client or prospect, but do not permit your client or prospect to attempt to sell your goods for you. The least desirable, but often an effective method, is through a letter of introduction which, if possible, should be followed, before contact, by a telephone call from you. Social contacts should not be overlooked. We are sometimes prone to forget the women employees of clients or prospects on whom we are calling. These are a definite ready market because it is natural for a woman employee to follow and have confidence in her boss, and if she is working, she has the money.

APPROACH TECHNIQUE

The usual type of approach to your average businessman is not always advisable in the case of women. Tones must be softened, opening leads must be less abrupt, more personal, and rarely, if ever, interrogatory. It is always wise to lead to your subject cautiously and keep uppermost the personal point of view. Great care must be taken that all statements made by you are literal, and it is well to remember that the average woman is not as well versed in business practice as is the average man. The "*you*" attitude is even more vital with women than with men and the use of the hypothetical proposition is apt to be fatal. In illustrating a point of view it is well to illustrate with the *client's problem* rather than with that of an unknown Mrs. Jones.

A STRONG CLOSING ESSENTIAL

While you will encounter procrastination, the desire to consult the family or the friend of the family, the banker or lawyer, it is often possible to speed the closing by the use of direct, firm, quiet pressure. Leaving no question unanswered, but bringing a client again and again to the closing point will definitely accomplish your purpose. There is more truth than poetry in the saying that "A woman's *no*, means *maybe*; and a woman's *maybe*, means *YES*."

Cordially yours,

DOUGLAS LAIRD,
Vice President In Charge of Sales.

Appendix E

SALES CIRCULAR OF CAPITAL SAVINGS PLAN, INC.¹

THE LIVING TRUST

The Capital Savings Plan is a Living Trust fund which is designed to build up a substantial estate for your own use during your lifetime.

By means of a Capital Savings Plan you are able to save in small amounts monthly and in later years to enjoy not only benefits of your savings but also the unlimited profits that your savings will earn.

A Capital Savings Plan is a sound method of saving and investing which maintains liquidity of your invested dollar and which provides all of the advantages to those of small or moderate incomes that heretofore have been available only to the enormously wealthy. A Capital Savings Plan also provides:

1. Retirement at a definite age.
2. Education for your children.
3. Ownership of your own home.
4. A reserve fund for depreciation of property.
5. Protection of your family in the event of death.
6. Protection for your savings.
7. The necessities of life under any economic conditions.
8. Travel and luxuries.
9. Profits on your savings.
10. A cash reserve fund for any emergency.
11. An interest in the business which employs you today.
12. Protection in the event of inflation or rising prices.

SAVING AND INVESTING

The Capital Savings Plan is a co-operative method of saving and investing money. The underlying securities for Capital Savings Plans are the common stocks of 42 corporations engaged in the basic industries of America. These securities, together with their accumulated profits, determine the worth of each Capital Savings Plan.

The 42 underlying stocks are bought with the investors' money and held in trust by the Pennsylvania Company—there is no speculation possible under the Capital Savings Plan system of saving and investing. Because the following securities are held in trust for the investors because this is a fixed rather than a management trust, the

¹ Hearings *In the Matter of Capital Savings Plan, Inc.*, held on June 2, 1938, pursuant to an order for investigation dated February 21, 1938, under Sections 19 (b) and 20 (a) of the Securities Act of 1933, Geary Exhibit No. 39.

financial conditions of Capital Savings Plan, Inc., can not affect the worth of the investors Plan at any time, nor can there be additional fees charged, nor are there any penalties

BASIC INDUSTRIES THAT WORK FOR YOU

Industrials

Allied Chemical.	General Electric.
Allis-Chalmers.	General Motors.
American Can.	International Harvester.
American Tobacco B.	National Biscuit.
Borden	Union Carbide and Carbon.
Corn Products	U. S. Steel.
DuPont.	Westinghouse.
Eastman Kodak.	Woolworth.

Utilities

American Gas and Electric.	Consolidated Edison of N. Y.
American Tel. and Tel.	Pacific Lighting.

Banks

Bankers Trust Co.	National City Bank.
Chase National Bank of N. Y.	New York Trust.
Continental Ill. (Chicago).	Philadelphia National.
First National Bank (Boston).	Security First National of L. A.
Manhattan Company.	

Rails

Atchison.	Pennsylvania R. R.
Chesapeake & Ohio.	Union Pacific.

Oils

Atlantic Refining.	Standard Oil of New Jersey.
Standard Oil of California.	Texas Corporation.
Standard Oil of Indiana.	

Insurance Companies

Aetna Life.	Home.
Fidelity-Phenix.	Insurance Co. of N. A.

THE TRUSTEE

All checks, money orders, and drafts covering payments on Contracts are made payable to "The Pennsylvania Company, Trustee." The Trustee for this Plan is responsible for the safe-keeping of all funds received from Certificate Holders, the investment of these funds as directed according to the Capital Savings Plan Trust Agreement after authorized deductions have been made, the safe-keeping

of Shares purchased, the collection and reinvestment of periodical distribution and dividends, and for certain other duties provided for by the terms of the Trust Agreement.

INSURANCE

At your option, and for a small sum deducted from your regular monthly payments you are provided with insurance which guarantees the completion of your Contract (up to \$10,000), as long as payments are made when due.

SOURCES OF PROFITS

A Capital Savings Plan is a Saving Plan with a liquidating value which includes profits derived from three sources, namely:

1. Dividends and distributions upon underlying common stocks.
2. The reinvestment or compounding of earnings and profits.
3. Appreciation or increased market value of the underlying securities.

LIMITED PAYMENTS—UNLIMITED PROFITS

A Capital Savings Plan has a maturity value far in excess of your actual savings, and yet your total cost for the entire fulfillment of a Contract is limited to 120 monthly payments. For each \$2,000 maturity value you cannot pay more than \$1,200. If the maturity value of your Plan is reached in less than 10 years, your payments cease and your Savings Goal is immediately available to you.

SAFETY

A Capital Savings Plan attains maximum safety by virtue of—

1. The "Fixed Trust" which eliminates manipulation and speculation or errors in personal judgment.
2. The Trustee arrangement with The Pennsylvania Company.
3. The diversified investment in 42 corporations engaged in the basic industries of America.
4. The ability to "average" over a period of years.
5. The maintenance of dollar purchasing power.
6. The insurance coverage in the event of death—this is optional.

LIQUIDITY

A Capital Savings Plan may be liquidated any day during regular trading hours, and, upon liquidation, you will receive the full market value of your invested dollar plus all of its accumulations and profits.

CONSTANT PURCHASING POWER

Economic factors which are beyond personal control are constantly causing inflation or deflation of currency values, and money put aside today may have less purchasing power in the future even though a definite amount of interest has been paid upon such money.

However, under the Capital Savings Plan of investing, the securities in which the money is invested would automatically rise, not only in proportion to any inflation, but also in anticipation of future inflation, thus, the purchasing power of your savings and your profits are assured no matter what the purchasing power of the dollar might be in years to come.

LATE PAYMENTS

A late payment carries no penalty and a payment which is missed only postpones the maturity of your Plan for the period of that payment.

"BORROWING POWER"

Money "borrowed" on your Plan carries no interest. Such a procedure is a partial liquidation and may or may not be replaced—this is optional with YOU.

THE COST

A Capital Savings Plan earns profits for you without limitation and you are able to enjoy the benefits of large investing power though you only save in small monthly amounts. Your total cost for the benefits of a Capital Savings Plan is only the small service fee as provided for in the Capital Savings Plan prospectus.

Appendix F

SUMMARY OF RECEIPTS AND DISPOSITIONS BY INSTALLMENT INVESTMENT PLANS, 1930-37

	1930	1931	1932	1933	1934
Number of plans.....	2	7	14	18	19
<i>Receipts</i>					
1. Payments by certificate holders.....	\$157,690	\$1,043,949	\$2,141,885	\$3,056,654	\$4,421,693
2. Transfer fees received.....			1	4	26
3. Realized upon exchanges.....					389,017
4. Proceeds from sales of underlying securities.....	1,595	23,679	97,958	1,107,498	795,742
5. Dividends received.....	7,589	36,237	221,280	197,381	176,906
6. Sale of stock dividends and rights.....					278
7. Interest earned.....			50	55	27
8. Life insurance benefits of deceased certificate holders.....					6,795
9. Investment of amount previously withheld for taxes.....					
10. Miscellaneous receipts.....			872	1,887	8,743
Total receipts.....	166,874	1,103,865	2,462,046	4,363,479	5,799,227
<i>Dispositions</i>					
1. Payments to certificate holders upon withdrawal.....		7,363	52,162	1,081,865	807,619
2. Dividends to certificate holders.....		22	2,553	2,482	8,220
3. Insurance refunds to certificate holders.....					256
4. Credited to new certificates upon exchanges.....					388,240
5. Underlying securities purchased.....	83,727	582,971	1,660,096	2,544,461	3,668,382
6. Sponsor's commissions and other fees.....	74,836	446,846	626,497	583,565	736,697
7. Management fees.....			269	513	1,498
8. Withdrawal fees.....			27	1,719	12,413
9. Delinquency fees.....				6	433
10. Trustee fees.....		5,306	30,158	42,514	62,250
11. Transfer fees.....		1	9	33	12
12. Life insurance premiums paid.....	8,063	55,355	81,376	73,369	99,760
13. Taxes paid and reserved.....			2,756	6,804	8,305
14. Miscellaneous dispositions.....	192	3,728	2,111	1,734	6,266
15. Excess of receipts over dispositions (deficit).....	56	2,273	4,032	24,414	(1,124)
Total dispositions.....	166,874	1,103,865	2,462,046	4,363,479	5,799,227

*Summary of Receipts and Dispositions by Installment Investment Plans,
1930-37—Continued*

	1935	1936	1937	Total
Number of plans.....	29	32	31	
<i>Receipts</i>				
1. Payments by certificate holders.....	\$7, 217, 896	\$14, 852, 873	\$19, 660, 193	\$52, 552, 833
2. Transfer fees received.....	76	146	158	411
3. Realized upon exchanges.....	121, 695		12, 388	523, 100
4. Proceeds from sales of underlying securities.....	1, 416, 006	4, 181, 600	3, 353, 412	10, 977, 490
5. Dividends received.....	313, 481	821, 551	1, 302, 449	3, 076, 874
6. Sale of stock dividends and rights.....	1, 397	1, 299	7, 477	10, 451
7. Interest earned.....	54	5, 129	12, 576	17, 891
8. Life insurance benefits of deceased certificate holders.....	7, 660	28, 836	50, 350	93, 641
9. Investment of amount previously withheld for taxes.....	7, 821			7, 821
10. Miscellaneous receipts.....	49, 222	63, 840	48, 798	173, 362
Total receipts.....	9, 135, 308	19, 955, 274	24, 447, 801	67, 433, 874
<i>Dispositions</i>				
1. Payments to certificate holders upon withdrawal.....	1, 464, 480	3, 282, 619	2, 866, 496	9, 562, 604
2. Dividends to certificate holders.....	13, 674	402, 533	204, 698	634, 182
3. Insurance refunds to certificate holders.....	2, 493			2, 749
4. Credited to new certificates upon exchanges.....	121, 648		4, 035	513, 923
5. Underlying securities purchased.....	6, 209, 831	13, 459, 156	17, 331, 277	45, 539, 901
6. Sponsor's commissions and other fees.....	987, 025	2, 190, 507	3, 342, 063	8, 988, 036
7. Management fees.....	3, 043	31, 310	77, 699	114, 332
8. Withdrawal fees.....	16, 151	17, 354	11, 968	59, 632
9. Delinquency fees.....	2, 005	480	1, 289	4, 213
10. Trustee fees.....	91, 354	146, 043	221, 262	598, 887
11. Transfer fees.....	13	144	152	364
12. Life insurance premiums paid.....	130, 427	208, 642	310, 346	967, 338
13. Taxes paid and reserved.....	14, 161	89, 200	85, 619	206, 845
14. Miscellaneous dispositions.....	23, 646	16, 555	10, 595	64, 827
15. Excess of receipts over dispositions (deficit).....	55, 357	110, 731	(19, 698)	176, 041
Total dispositions.....	9, 135, 308	19, 955, 274	24, 447, 801	67, 433, 874

Appendix G

COMPOSITE STATEMENT OF ASSETS AND LIABILITIES OF INSTALLMENT INVESTMENT PLANS, 1930-37

	1930	1931	1932	1933	1934	1935	1936	1937
Number of plans.....	2	7	14	18	19	29	32	31
<i>Trust assets</i>								
Cash.....	\$56	\$3,094	\$22,091	\$49,651	\$45,057	\$230,271	\$325,130	\$409,062
Securities at market value....	65,525	400,894	1,604,394	3,740,438	5,880,891	12,879,921	24,406,463	24,048,010
Accrued interest and dividends receivable.....		81	271	182	642	3,905	150,436	61,273
Other receivables.....			1,601	4,781	4,278	12,611	5,694	476
Insurance fund.....	2,363	8,014	9,630	6,123	10,121	11,235	18,077	27,137
Tax fund.....			1,945	7,628	14,929	4,175	45,936	48,978
Trustee fee fund.....						1,770		4
Deferred expense.....			116	100	100			
Other assets.....						857	23,580	
Total assets.....	67,944	412,083	1,640,048	3,808,903	5,956,018	13,144,745	24,975,318	24,594,940
<i>Trust liabilities</i>								
Equity of certificate holders..	65,581	403,104	1,621,106	3,783,090	5,910,879	13,072,874	24,775,269	24,363,239
Service fees payable.....		73	857	669	666	4,041	3,819	7,410
Trustees fees payable.....			880	1,476	2,137	4,102	11,360	15,058
Insurance premiums payable..	2,363	8,780	327	880	3,433	8,127	20,797	38,818
Accounts payable—securities.....			1,590	2,769	2,957	5,426	45,049	28,341
Reserve for insurance premiums.....			9,740	6,550	11,015	15,498	26,007	28,930
Reserve for taxes.....		126	3,480	7,649	15,868	20,810	74,733	101,193
Reserve for contingencies.....			214	3,160	8,853	8,017	2,909	2,480
Deposit by sponsor.....			1,854	2,190		2,645		98
Suspense (awaiting issuer company's approval).....				470	210	2,730	2,360	2,788
Other liabilities.....						475	13,013	6,585
Total liabilities.....	67,944	412,083	1,640,048	3,808,903	5,956,018	13,144,745	24,975,316	24,594,940

Appendix H

PERFORMANCE RECORD OF INSTALLMENT INVESTMENT PLANS, 1930-37

[Amounts in dollars]

	Year ending Dec. 31				
	1930	1931	1932	1933	1934
Number of plans.....	2	7	14	18	29
1. Net assets of plans, beginning of period.....		65,581	403,104	1,621,106	3,783,090
2. Payments by certificate holders.....	157,690	1,043,949	2,141,886	3,056,658	4,421,719
3. Proceeds from insurance of deceased certificate holders.....					6,795
4. Total principal invested (1+2+3).....	157,690	1,109,530	2,544,990	4,677,764	8,211,604
5. Payments to certificate holders upon withdrawal.....		7,363	52,162	1,081,865	807,875
6. Sponsors' commissions and other fees	74,836	446,847	626,533	585,323	749,555
7. Trustees' fees.....		5,306	30,158	42,514	62,250
8. Management fees.....			269	513	1,498
9. Insurance premiums paid.....	8,063	55,355	81,376	73,369	99,760
10. Total principal deductions (5 through 9).....	82,899	514,871	790,498	1,783,584	1,720,938
11. Net principal invested 4-10).....	74,791	594,659	1,754,492	2,894,180	6,490,666
12. Gross ordinary income.....	7,589	36,237	222,202	199,323	185,954
13. Taxes paid and reserved.....			2,756	6,804	8,305
14. Other expenses charged to income.....	192	3,728	2,111	1,734	6,266
15. Dividends to certificate holders.....		22	2,553	2,482	8,220
16. Total deductions from income (13+14+15).....	192	3,750	7,420	11,020	22,791
17. Net income reinvested (12-16).....	7,397	32,487	214,782	188,303	163,163
18. Total invested (11+17).....	82,188	627,146	1,969,274	3,082,483	6,653,829
19. Net assets of plans, end of period.....	65,581	403,104	1,621,106	3,783,090	5,910,879
20. Realized and unrealized appreciation (depreciation) of trust assets at end of period (19-18).....	(16,607)	(224,042)	(348,168)	700,607	(742,950)
21. Percent of appreciation (depreciation) to total invested (20÷18)×100.....	(20.2)	(35.7)	(17.7)	22.7	(11.2)

Performance Record of Installment Investment Plans, 1930-37—Continued

	Year ending Dec. 31			Cumulative 1930-37
	1935	1936	1937	
Number of plans.....	21	32	^b 31	^b 33
1. Net assets of plans, beginning of period.....	5,910,879	13,072,874	24,002,440	
2. Payments by certificate holders.....	7,217,972	14,853,019	19,660,351	52,553,244
3. Proceeds from insurance of deceased certificate holders.....	7,660	28,836	50,350	93,641
4. Total principal invested (1+2+3).....	13,136,511	27,954,729	43,713,141	52,646,885
5. Payments to certificate holders upon withdrawal.....	1,466,973	3,282,619	2,866,496	9,565,353
6. Sponsors' commissions and other fees ^a	1,005,194	2,208,485	3,355,472	9,052,245
7. Trustees' fees.....	91,354	146,043	221,262	598,887
8. Management fees.....	3,043	31,310	77,699	114,332
9. Insurance premiums paid.....	130,427	208,642	310,346	967,338
10. Total principal deductions (5 through 9).....	2,696,991	5,877,099	6,831,275	20,298,155
11. Net principal invested (4-10).....	10,439,520	22,077,630	36,881,866	32,348,730
12. Gross ordinary income.....	364,154	891,819	1,371,300	3,278,578
13. Taxes paid and reserved.....	6,340	89,200	85,619	199,024
14. Other expenses charged to income.....	23,646	16,555	10,595	64,827
15. Dividends to certificate holders.....	13,674	402,533	204,698	634,182
16. Total deductions from income (13+14+15).....	43,660	508,288	300,912	898,033
17. Net income reinvested (12-16).....	320,494	383,531	1,070,388	2,380,545
18. Total invested (11+17).....	10,760,014	22,461,161	37,952,254	34,729,275
19. Net assets of plans, end of period.....	13,072,874	24,775,269	24,363,230	25,136,068
20. Realized and unrealized appreciation (depreciation) of trust assets at end of period (19-18).....	2,312,860	2,314,108	(13,589,015)	(9,593,207)
21. Percent of appreciation (depreciation) to total invested (20÷18)×100.....	21.5	10.3	(35.8)	(27.6)

^a Includes withdrawal, delinquency, and transfer fees.

^b Data were not available for 2 plans included in prior years. These plans are therefore excluded in 1937. For the period 1930-37 the figure representing net assets of 33 plans at the end of 1937 includes the net assets of these 2 plans as at the end of 1936.

Appendix I

INVESTORS' EXPERIENCE IN INSTALLMENT INVESTMENT PLANS BY YEARS, 1930-37

[Amounts in dollars]

	Years ending Dec. 31				
	1930	1931	1932	1933	1934
Number of plans.....	2	7	14	18	19
1. Net assets of plans at beginning of period.....		65,581	403,104	1,621,106	3,783,090
2. Payments by certificate holders ^a	157,690	1,043,949	2,141,886	3,056,658	4,421,719
3. Total invested during period (1 and 2)....	157,690	1,109,530	2,544,990	4,677,764	8,204,809
4. Payments to certificate holders upon withdrawals ^b		7,363	52,162	1,081,865	807,875
5. Dividends paid to certificate holders.....		22	2,553	2,482	8,220
6. Total returned to certificate holders (4 and 5).....		7,385	54,715	1,084,347	816,095
7. Net investment of certificate holders at end of period (3-6).....	157,690	1,102,145	2,490,275	3,593,417	7,388,714
8. Net assets of plans at end of period.....	65,581	403,104	1,621,106	3,783,090	5,910,879
9. Net gain (loss) to certificate holders for period (8-7).....	(92,109)	(699,041)	(869,169)	189,673	(1,477,835)
10. Percentage of gain (loss) to total invested (9÷3)×100.....	(58.4)	(63.0)	(34.2)	4.1	(18.0)
11. Percentage of gain (loss) to net investment (9÷7)×100.....	(58.4)	(63.4)	(34.9)	5.3	(20.0)

	Years ending Dec. 31			Cumulative 1930-37
	1935	1936	1937	
Number of plans.....	29	32	c 31	c 33
1. Net assets of plans at beginning of period....	5,910,879	13,072,874	24,002,440	-----
2. Payments by certificate holders ^a	7,217,972	14,853,019	19,660,351	52,553,244
3. Total invested during period (1 and 2).....	13,128,851	27,925,893	43,662,791	52,553,244
4. Payments to certificate holders upon withdrawals ^b	1,466,973	3,282,619	2,866,496	9,565,353
5. Dividends paid to certificate holders.....	13,674	402,533	204,698	634,182
6. Total returned to certificate holders (4 and 5).....	1,480,647	3,685,152	3,071,194	10,199,535
7. Net investment of certificate holders at end of period (3-6).....	11,648,204	24,240,741	40,591,597	42,353,709
8. Net assets of plans at end of period.....	13,072,874	24,775,269	24,363,239	25,136,068
9. Net gain (loss) to certificate holders for period (8-7).....	1,424,670	534,528	(16,228,358)	(17,217,641)
10. Percentage of gain (loss) to total invested (9÷3)×100.....	10.9	1.9	(37.2)	(32.8)
11. Percentage of gain (loss) to net investment (9÷7)×100.....	12.2	2.2	(40.0)	(40.7)

^a Includes payments on unissued accounts (\$295) and transfer fees (\$411).

^b Includes insurance refunds \$2,749.

^c Data were not available for 1937 for 2 plans included in prior years. These plans are therefore excluded in 1937. For the period 1930-37, the figure representing net assets of 33 plans at the end of 1937 includes the net assets of the 2 plans as at the end of 1936.

Appendix J

CUMULATIVE INVESTORS' EXPERIENCE IN INSTALLMENT INVESTMENT PLANS, 1930-37

[Amounts in dollars]

	January 1, 1930 through December 31			
	1930	1931	1932	1933
Number of plans.....	2	7	14	18
1. Payments by certificate holders ^a	157,690	1,201,639	3,343,525	6,400,183
2. Payments to certificate holders upon withdrawals ^b		7,363	59,525	1,141,390
3. Dividends paid to certificate holders.....		22	2,575	5,057
4. Total returned to certificate holders (2 and 3).....		7,385	62,100	1,146,447
5. Net investment of certificate holders at end of period (1-4).....	157,690	1,194,254	3,281,425	5,253,736
6. Net assets of plans at end of period.....	65,581	403,104	1,621,106	3,783,090
7. Net loss to certificate holders for period (6-5).....	92,109	791,150	1,660,319	1,470,646
8. Percentage of loss to total invested $(7 \div 1) \times 100$	58.4	65.8	49.7	23.0
9. Percentage of loss to net investment $(7 \div 5) \times 100$	58.4	66.2	50.6	28.0

	January 1, 1930 through December 31			
	1934	1935	1936	1937
Number of plans.....	19	29	c 32	c 31
1. Payments by certificate holders ^a	10,821,902	18,039,874	32,892,893	52,553,244
2. Payments to certificate holders upon withdrawals ^b	1,949,265	3,416,238	6,698,857	9,565,353
3. Dividends paid to certificate holders.....	13,277	26,951	429,484	634,182
4. Total returned to certificate holders (2 and 3).....	1,962,542	3,443,189	7,128,341	10,199,535
5. Net investment of certificate holders at end of period (1-4).....	8,859,360	14,596,685	25,764,552	42,353,709
6. Net assets of plans at end of period.....	5,910,879	13,072,874	24,775,269	25,136,068
7. Net loss to certificate holders for period (6-5).....	2,948,481	1,523,811	989,283	17,217,641
8. Percentage of loss to total invested $(7 \div 1) \times 100$	27.2	8.4	3.0	32.8
9. Percentage of loss to net investment $(7 \div 5) \times 100$	33.3	10.4	3.8	40.7

^a Includes payments on unissued accounts (\$295) and transfer fees (\$411).

^b Includes insurance refunds \$2,749.

^c Data were not available for 1937 for 2 plans included in prior years. These plans are therefore excluded in 1937. For the period 1930-37, the figure representing net assets of 33 plans at the end of 1937 includes the net assets of the 2 plans as at the end of 1936.

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